

## Chapter 3

# Reasons: Decisions, Orders and Rulings

### 3.1 REASONS

### DECISION AND REASONS

#### 3.1.1 E.A. MANNING LIMITED ET AL.

IN THE MATTER OF THE SECURITIES ACT,  
R.S.O. 1990, CHAPTER S.5, AS AMENDED

AND

IN THE MATTER OF E.A. MANNING LIMITED,  
JUDITH MARCELLA MANNING, TIMOTHY EDWARD  
MANNING, WILLIAM  
DOUGLAS ELIK, MARY MARTHA FRITZ, MARC HAROLD  
SCHWALB  
PETER JOHN FINANCE, RICHARD JOHN NEWELL,  
AND JILL CHRISTINE BOLTON

Hearing:	September 6, 7, 8, 11, 12, 13, 14, 15, 18, 20, 21 and 29, 1995	
Panel:	J. A. Geller, Q.C. - H.M. Meyer -	Vice-Chair Commissioner
Counsel:	James Douglas ) Steven Sofer ) Mark Gordon )	For the Staff of the Ontario Securities Commission
	Alan Lenczner, Q.C. -	For E.A. Manning Limited, Judith Marcella Manning, Timothy Edward Manning, William Douglas Elik and Mary Martha Fritz
	Paul Layefsky -	for Jill Christine Bolton

#### Nature of the Proceedings

In these proceedings, the staff (the "Staff") of the Ontario Securities Commission (the "Commission") alleged, as its principal allegation, that the Respondents failed to deal fairly, honestly, and in good faith with the clients and/or potential clients of the Respondent E.A. Manning Limited ("Manning"), did not act in the best interests of such clients and potential clients, and engaged in conduct contrary to the public interest.

The Staff also alleged, inter alia, that Manning failed to send statements of account to clients in accordance with subsection 123(2) of the regulation (the "Regulation") under the *Securities Act* (the "Act"), that Manning and Mary Martha Fritz ("Fritz") failed to establish and/or enforce procedures for dealing with clients that conform with prudent business practice in accordance with subsection 114(1) of the Regulation, that between May and September 1994 Manning employed an individual who engaged in trading in securities and who was not registered in accordance with section 26 of the Act, that Manning, Judith Marcella Manning ("Judith Manning"), Timothy Edward Manning ("Ted Manning"), William Douglas Elik ("Elik") Mark Harold Schwalb ("Schwalb") and Peter John Finance ("Finance") instructed salespersons to use improper sales practices, and that Manning, Judith Manning and Fritz failed to adequately supervise salespersons of Manning.

The Staff asked the Commission to exercise its powers under clauses 127(1) 1. and 3. of the Act to sanction the Respondents in connection with the activities alleged. These clauses of the Act read as follows.

"127.(1) The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders;

1. An order that the registration or recognition granted to a person or company under Ontario securities law be suspended or restricted for such period as is specified in the order or be terminated, or that terms and conditions be imposed on the registration or recognition.
3. An order that any exemptions contained in Ontario securities law do not apply to a person or company permanently or for such period as is specified in the order."

The proceedings against Schwalb and Richard John Newell were settled by agreements between them and the Staff, approved by another panel of the Commission.

#### Subsection 127(5) Application

The allegations against the Respondents were initially brought before the Commission by the Staff on February 2, 1994 by way of an application under subsection 127(5) of the Act for an interim order suspending the registration of the Respondents. Subsection 127(5) provides as follows.

"Despite subsection (4), if in the opinion of the Commission the length of time required to conclude a hearing could be prejudicial to the public interest, the Commission may make a temporary order under paragraph 1, 2 or 3 of subsection (1) or subparagraph ii of paragraph 5 of subsection (1)."

The panel of the Commission which heard the application refused to make the order requested, and directed the Staff to issue a notice of hearing if so advised. The Staff did issue a notice of hearing with a first return date of February 25, 1994.

#### Adjournments

On the first return date, Alan Lenczner Q.C. appeared before the Commission representing Manning, Judith Manning, Ted Manning, Elik and Fritz. (Jill Christine Bolton ("Bolton") was subsequently added as a respondent in these proceedings, from which time until the commencement of the hearing on September 6, 1994 Mr. Lenczner represented her in these proceedings as well.)

On February 25, 1994 and from time to time thereafter the hearing in these proceedings was adjourned at the request of Mr. Lenczner and of Schwalb's counsel. Such adjournments were requested as a result of judicial proceedings brought by the Respondents against the Commission. On each occasion, new dates were set taking into account Mr. Lenczner's submissions as to the anticipated length of the hearing and to accommodate his schedule.

On May 18, 1995, Mr. Lenczner appeared before a panel of the Commission and requested that the hearing be adjourned from June 7, 1995 to the first week in September, in part due to a proposed application for leave to appeal to the Supreme Court of Canada, and in part to accommodate his schedule. The panel granted the requested adjournment and set the date of the commencement of the hearing at September 6, 1995. The panel indicated that the hearing would commence on that date, without further adjournment, unless the Supreme Court of Canada ordered otherwise. That Court rejected the leave to appeal application by judgment dated August 17, 1995.

#### Mr. Lenczner's Opening Statement

The hearing did commence on September 6, 1995. Mr. Lenczner represented all of the clients for whom he had acted

throughout the proceedings save for Bolton, who was separately represented. After the delivery of an opening statement by counsel for the Staff, Mr. Lenczner delivered his "opening statement", which contained serious allegations against the Staff, and about the purposes of the Staff in commencing these proceedings and the methods used by them, and as to the character of certain of the witnesses expected to be called by the Staff, as well as what can only be described as unsworn evidence by Mr. Lenczner on a number of issues germane to the proceedings. We permitted him to do so because we assumed, and in our view were entitled to assume, that he would be supporting these allegations and this "evidence" by sworn testimony of the witnesses whom he would be calling. Indeed, in response to questions and comments by the panel and counsel for the Staff, Mr. Lenczner gave no intimation that he and his clients would be withdrawing from the hearing until the very end of his presentation, when Mr. Lenczner stated that his clients

"are not in a position to use their resources to pursue this hearing. And I will leave it to your good graces and Ms. Meyer's good graces to look after the evidence, and [his clients] are going to exempt themselves and have instructed me to depart at this point."

The following exchange then took place between Vice-Chair Geller and Mr. Lenczner.

"THE CHAIRMAN: I think I should say that this if you will leaves the Panel in some difficulty in the sense that you have made a lot of statements this morning, Mr. Lenczner, but you are not going to be here to test the evidence we get in cross-examination or any other way. And to impose on the Commission the obligation to play the role is I think more than we can be properly expected by you to do. I understand you have your instructions and must abide by them, but I have to say that from the point of view of assisting the Commission in coming to a reasoned decision in these proceedings, the instructions you have been given are far from helpful.

MR. LENCZNER: I appreciate that and the choice was not to raise any of these things at all and not to appear at all today and to leave you. But my client felt that that was wrong, that when you listen to some of these witnesses for which we have provided you evidence or information, that you should know, you should be put in the picture in the best possible way we could put you in the picture.

My clients have a lot of confidence in the Commission and my clients appreciate that that does place a difficult burden on you. And obviously we can't ask you to descend into the arena and cross-examine every witness, et cetera. But we thought you ought to be aware

that the story and the picture was not at all one-sided, that there were, that you have to be careful when listening to the evidence. And it's unfortunate but as I say, my clients have as you have already heard made a lot of changes of [sic] the years and they just haven't had any feeling of assistance from the Staff of the Commission with rectifying any problems. All it has been is a ---

THE CHAIRMAN: You have a lot of statements on the record, Mr. Lenczner. We have no evidence on any of these points and I think you are really again by repeating that kind of allegation without being here to put in evidence on these points, making it very, very difficult for the Commission to deal with this sort of thing. I mean, you have made a lot of very strong statements; not improper at all but very strong statements. And then left it to us without any evidence to back them up to be suspicious of various things and such. You have your instructions but once again, all I can say is it's most unhelpful.

MR. LENCZNER: Well, I appreciate what you have said and I don't mean to push it, other than to tell you we have given you the back-up as best we can in these exhibits so that you will have available to you and perhaps Staff will have available to them a different view of the picture."

Indeed Mr. Lenczner's statements would not, in our view, have been improper if he had made them intending to attempt to back them up with credible evidence.

We were, to say the least, surprised and shocked by Mr. Lenczner's actions. We suspect that had Mr. Lenczner attempted to do such a thing before a Court, he would have faced contempt proceedings. We do not consider it proper for counsel, and particularly experienced and able counsel, to make in an opening statement factual allegations that he does not intend to try to prove with credible evidence. In addition, during his statement, Mr. Lenczner undertook to file documents or copies of documents which he had referred to or had submitted. He did not choose to honour these undertakings.

In a factum subsequently filed by him in response to our request to counsel to make submissions as to how we should treat Mr. Lenczner's opening statement, he said, *inter alia*:

"8. A disciplinary hearing, under the *Act*, it is not an adversarial proceeding of interest only to the parties involved. The Commission has an independent duty to inquire and to be satisfied that it is discharging its dual role, as stated above. The Commission must take into account the following:

- (a) The evidence and exhibits that it admitted in the opening statements, at its own initiation and with consent of counsel for staff;
- (b) The indications given to it by counsel for the respondents of the background, context and weaknesses to be found in the case to be presented by staff.

9. The commissioners cannot sit by and accept the evidence presented by counsel for staff, without inquiring into such evidence and taking account of the frailties of such evidence to which they have been alerted. The commissioners are entitled to and have an obligation to examine on the evidence by asking questions. For example:

- (i) With respect to the witness Schwalb, questions should be put respecting his previous sworn affidavit at Volume 20, Tab 1;
- (ii) With respect to the witness Newell, his evidence and plea bargain should be juxtaposed against his immediately subsequent conduct in Manila;
- (iii) With respect to the witness Ghanaghounian, his interaction with staff must be considered as set out in Volume 1, Tabs 15, 18, 23, and 32."

Much as we objected to Mr. Lenczner's actions, we nevertheless felt obliged to take into account the allegations and statements made by Mr. Lenczner when we considered the evidence that was presented to us by Staff. We will, in the course of these Reasons, be referring to specific such allegations and statements when reviewing the evidence which we heard. Suffice it to say at this point that, with rare exceptions, what we were told by Mr. Lenczner did not accord with the evidence which we heard, especially as regards the former Manning customers. Perhaps, if he had been present to cross-examine the witnesses or to lead his own evidence the situation would have been different. But he was not. And this was his choice, or that of his clients.

#### Request for Adjournment

After Mr. Lenczner's withdrawal, Mr. Layefsky, representing Bolton (who, it will be remembered, was represented by Mr. Lenczner up to the commencement of the hearing), requested an adjournment lengthy enough to enable Bolton to retain counsel and counsel so retained to review documents and prepare his or her case. He also requested a severance, if the panel decided that it should go ahead with the hearing as regards the other Respondents.

Mr. Douglas, on behalf of the Staff, opposed both requests. He objected to the request for a severance on the

basis that a severance would in effect require substantially a complete rehearing, since much of the evidence relating to the other Respondents also related to Bolton. (Indeed, this proved to be the case when the evidence was presented.) As regards the request for an adjournment, Mr. Douglas pointed out that the hearing had already been adjourned, at the request of Bolton's then counsel, a number of times and for a protracted period, and that at the last adjournment it had been made clear by the Commission that the hearing would commence on this date. He also submitted that this not being a criminal proceeding, the criminal and constitutional law arguments as to a right to counsel were not applicable. Mr. Douglas offered assistance to Mr. Layefsky or any other counsel retained by Bolton in making it as easy as reasonably possible in getting into and understanding the case.

The panel ruled as follows.

"THE CHAIRMAN: Firstly, this is clearly not a criminal proceeding. In deciding whether to grant a request for an adjournment the Commission has to take into account not only the interests and the rights of the respondent; obviously we have to take that into account. But also, the public interest which weighs on the other side. Now the courts and the Commission have made it clear over a number of years that delays in this sort of proceeding are not in the public interest. We have every sympathy with Ms. Bolton. However, under the circumstances and given the history of this matter, where properly there have been delays pending court applications and everything else.

But the public interest to the extent that there have been delays has been prejudiced in our view under the authorities and would by giving you the sort of adjournment that counsel is requesting, which is not a day or two, be further prejudiced. We think in these circumstances the public interest requirement for a speedy proceeding outweighs the prejudice to the respondent.

We have taken into account Mr. Douglas' offer of assistance and we would expect that if Ms. Bolton does retain counsel that that offer would indeed be honoured and fully honoured so as to make it as easy as possible for counsel to step into this thing. In any event, we are going to proceed with the hearing."

We recognized that we must be concerned both with Bolton's right to a fair hearing in a case where the result might be to prevent her from earning a livelihood in the business in which she has been engaged for many years, and the public interest in an early hearing where the allegations, if proved, could establish a clear and present danger to investors and the capital markets of Ontario. To quote the language of the Commission in *In the Matter of Terence Edward Robinson et al* (1993), 16 O.S.C.B. 6173 at 6182:

"The Commission is accustomed to carrying out its duty to protect members of the public from the misconduct of participants in the capital markets while at the same time dealing fairly with those whose livelihoods are in its hands, both of which duties are in the words of Dubin, J.A. in the *Latimer* case referred to above [*Re W.D. Latimer Co. Ltd and A.-G. Ont; Re Onuska and Bray* 6 O.R. (2d) 129] "by statute clearly placed upon it, and nothing is to be gained, in my opinion, by placing a priority upon one of its functions over the other".

The Commission's concerns about delays in hearings in a matter such as the one before us were well expressed in *In the Matter of Terence Edward Robinson et al* (1993), 16 O.S.C.B. 5667 at 5671, where the Commission said:

"If we were to grant a stay of this hearing pending completion of the criminal proceedings it would be months or perhaps years before this hearing is complete. We are of the opinion that such delay in hearing this matter would be contrary to the public interest.

The Commission views its mandate to be to protect investors and to foster capital formation and the efficiency and integrity of the capital markets. In the case of *Brosseau v. Alberta Securities Commission* (1989), 57 D.L.R. (4th) 458 (S.C.C.) L'Heureux - Dubé J. made the following comments about the role of securities commissions at p. 467:

"Securities Acts in general can be said to be aimed at regulating the market and protecting the general public. This role was recognized by this court in *Gregory & Co. Inc. v. Quebec Securities Com'n* (1961), 28 D.L.R. (2d) 721 at p. 725, [1961] S.C.R. 584 at p. 588, where Fauteux J. observed:

The paramount object of the Act is to ensure that persons who, in the province, carry on the business of trading in securities or acting as investment counsel, shall be honest and of good repute and, in this way, to protect the public, in the Province or elsewhere, from being defrauded as a result of certain activities initiated in the Province by persons therein carrying on such a business.

This protective role, common to all securities commissions, gives a special character to such bodies which must be recognized when assessing the way in which their functions are carried out under their Acts."

It is in the public interest for this Commission to hear this matter as soon as possible to determine whether we ought to make an order removing the Respondents from participation in the public markets and thereby protect those public markets. The public expects and requires that this Commission will move expeditiously to deal with market participants who are alleged to have engaged in conduct which is abusive of the capital markets. The need to deal expeditiously with allegations of misconduct is of particular concern in a case such as this where the allegations against the Respondents, if proved, are serious.

Furthermore, in order to be able to regulate the capital markets effectively, it must be clear to market participants that the Commission can and will deal with matters such as these in a reasonably expeditious way. We are troubled by the trend that is developing in hearings before the Commission towards a proliferation of pre-hearing proceedings resulting in lengthy delays, in at least one case several years, between the time Notices of Hearing are issued and hearings are completed. This trend, if not addressed, could lead to an erosion of the Commission's credibility and its ability to fulfil its mandate of protecting investors and fostering the efficiency and integrity of the capital markets.

It is also in the public interest to have hearings held as soon as possible before memories fade and witnesses potentially become unavailable. In this case almost one year has elapsed since the Notice of Hearing was issued. Also, in this case a motion has already been brought on behalf of Mr. Latchman to stay the hearing against him under section 24(1) of the Charter on the grounds that as a result of the lengthy delay in bringing these matters before the Commission Mr. Latchman's rights to fundamental justice and to a fair trial have been infringed and he has been prejudiced because a witness who would have had material relevant evidence to give in relation to the defence of the matter had died. While counsel for Mr. Latchman did not proceed with the motion, it is indicative of the problems that can arise from delays in proceedings."

These decisions are always something of a balancing act. In the circumstances, we decided that Mr Douglas' offer of assistance, which we accepted as having been made in good

faith, and some flexibility by us in scheduling the proceedings, should be sufficient to ensure Bolton a fair hearing without an adjournment or severance.

On the next day (September 7, 1995), Mr. Layefsky, largely because of timing conflicts on his part, renewed his request for an adjournment, this time for a two-week to one-month period, or a severance. We ruled as follows:

"THE CHAIRMAN: Mr. Layefsky, as the Panel said yesterday, we recognize that it's a balancing act. Our obligation to be fair to Ms. Bolton and indeed to all the respondents, and our obligation in the public interest to move a hearing of this sort ahead. There is a background which we can't ignore which is that this hearing has been postponed and postponed and postponed, and then postponed again. And the one thing the Panel made abundantly clear when it was postponed last was that it was going to start yesterday unless the Supreme Court of Canada told us that we could not do it. We felt an obligation once again in the public interest not to permit further delays when there had already been so many.

We are very sympathetic to your position and sympathetic to Ms. Bolton's position. But we do not think that we cannot [sic] grant you an adjournment at this stage. I think the best we can do is to ask that counsel for Staff and you discuss further the timing of when the witnesses are going to be presented so as to accommodate Mr. Layefsky in every way which you reasonably can.

We do not think it is a proper case for severance and we think we should go ahead with the hearing. But we do urge Staff counsel together with you to make whatever accommodations would best serve Ms. Bolton's interest in the matter. And again as I have said, if that means that we will have a day or so from time to time when we don't sit on the matter, that we do not regard as the end of the world. We are quite prepared to accommodate counsel in attempting to accommodate each other in this matter."

On the following day (September 8, 1995), Mr. Layefsky advised us that, in view of our refusal to grant an adjournment which would enable him to prepare his case and rearrange his schedule, he was in a situation in which he could not continue to act, and that Bolton would be absenting herself from the proceedings at that point on.

**Witnesses Called and Affidavits Filed**

The Staff called the following witnesses, who gave evidence on the stand.

(a) Former Manning Trainees

1. Krikor Ghanaghounian ("Krikor")
2. Roman Sereda ("Sereda")

(b) Former Manning Salespersons

1. Schwalb
2. Peter Darling ("Darling")
3. James Gray ("Gray")

(c) Former Manning Customers

1. Henry Kreuger ("Kreuger")
2. Lisa Nageleisen ("Nageleisen")
3. Rick Normoyle ("Normoyle")
4. John Dritsas ("Dritsas")
5. John Sisson ("Sisson")
6. Jonathan Balter ("Balter")
7. Nicholas Moor ("Moor")
8. Paul Jarvis ("Jarvis")
9. George Estephan ("Estephan")
10. Hubert Bray ("Bray")
11. Joe Zaccaganini ("Zaccaganini")

## (d) Roy Hill, the Manager of Canadian Dealing Network Inc. ("CDN").

## (e) Brian Butler, a Senior Forensic Accountant on the Staff.

## (f) Arthur Lawrence, a Chartered Accountant.

Affidavits were submitted on behalf of the following:

## (a) Douglas Webb ("Webb"), a former Manning customer.

## (b) Mark Gordon, an Enforcement Counsel on the Staff.

## (c) John Moses, President of Willingdon Resources Inc.

## (d) Gordon Badger, President of Star Group Newspaper Networks Inc.

## (e) Peter Rooney, President of Golden Eagle Capital Inc.

The evidence of the former Manning salespersons and former Manning trainees (collectively, the "Inside Witnesses"), although it differed in some respects in detail, was, as regards the significant aspects of the manner in which Manning trained its salespersons, carried on its selling activities and supervised its salespersons and selling activities, consistent and, in our

view and except as specifically stated below in these Reasons, credible and believable.

Similarly, the evidence of the former Manning customers was, in all material respects, consistent, and also consistent with that of the Inside Witnesses. The former Manning customers did not always recollect in detail everything which had been said to them by Manning salespersons and officers. It would be surprising if they did. But what they did recollect and testify to was credible and believable.

We were assisted in understanding the testimony of the former Manning customers by being able to listen to, and read transcripts of, tape recordings made by Webb of parts or the whole of a large number of telephone conversations between Webb and Manning salespersons and officers, including Judith Manning, Ted Manning, Elik and Bolton. It is one thing to be told what salespersons and officers of Manning said. It is another to be able to actually hear what was said, the actual words used, and especially how it was said. These tape recordings lent even greater credibility to the testimony of the former Manning customers and, to a considerable extent, to that of the Inside Witnesses.

Accordingly, except as specifically stated below in these Reasons, we accept the evidence of the Inside Witnesses and the former Manning customers.

**Speculation and Hearsay**

Some of the evidence which we heard involved speculation by a witness as to what was in another person's mind or as to why another person took a particular action. During the course of the hearing, we advised that we would disregard such evidence, and we have done so.

As permitted by subsection 15(1) of the Statutory Powers Procedure Act, we admitted hearsay evidence. However, when such evidence was the only evidence on a particular issue, we have given it very little weight. To the extent that the evidence was corroborative of other evidence, on the other hand, we were prepared to give it greater weight.

**Inside Witnesses***Krikor*

Krikor was employed by Manning as a Qualifier from August 3, 1993 to August 31, 1993. As a Qualifier he made cold calls to individuals to ask them whether they wished to receive the Manning newsletter. The names of the individuals to be telephoned were selected by him from telephone directories covering various districts of Ontario. Those who agreed to receive the newsletter were told that in about three months they would be called by a Manning representative. After August 31, 1993, he returned to York University to complete his M.B.A program there. On January 4, 1994, he again commenced working at Manning, this time as a trainee Opener. He kept very detailed notes with respect to the

training process, and these notes were filed as part of an exhibit. He left Manning's employment on January 14, 1944.

During the first period of his employment with Manning, Krikor approached the Staff to tell of his concerns as to Manning's activities. Just why he first approached the Staff and why he returned to Manning's employment for the short period in 1994 is not clear to us from his evidence. Mr. Lenczner characterized him as "a spy for the Securities Commission". Krikor denied that he was acting at the instance of the Staff. Our suspicion is that he saw himself as a bit of a crusader, and saw his role as exposing activity which he considered to be improper, and that the Staff saw him as a means of obtaining evidence as to suspected improper activities at Manning. Krikor's actions can be characterized as spying, or, alternatively, as the actions of a public spirited citizen who was determined to expose what he perceived as improper activities of a registrant under the Act.

Whatever the explanation, neither Krikor nor the Staff was, in our view engaging in an improper activity, or one which should lead us to disregard his evidence. In any event, except, perhaps, for his explanations as to why he first approached the Staff and the reason for his return to Manning's employment, his evidence appeared to us to be perfectly credible, and was consistent with the evidence of the other Inside Witnesses, and also, to a considerable extent, the evidence of the former Manning customers.

#### *Sereda*

Sereda was employed by Manning from March 28, 1994 until June 6, 1994, first as a Qualifier and then, for about a week, as a trainee Opener. Prior to the commencement of his employment with Manning, he had been employed in sales for about 25 years, but not in the securities industry. He stated that he left Manning during the training period because he had always been trained in the past to have, in professional sales, integrity, and that he "couldn't stomach this high pressure sales and knowing that it is a scam basically in my heart".

#### *Schwalb*

Schwalb was employed by Manning as an Opener for something less than three years, ending in March of 1995. He commenced working in the securities industry in 1986, and prior to working for Manning had been employed by four other registrants during most of the intervening period. He is currently unemployed.

Schwalb was a Respondent in these proceedings. As above stated, the proceedings against him were settled by agreement between him and the Staff, approved by another panel of the Commission.

In 1993, Schwalb swore an affidavit which was filed in an action which had been commenced by Manning and others against the Commission and Donald Page, then a member of the Staff. The affidavit was extremely complementary of Manning and the manner in which it operated. Mr. Lenczner urged us to consider the affidavit when listening to Schwalb's

testimony, because his evidence was going to be completely different from what he swore in his affidavit. We did so. Schwalb's explanation for his complementary references to Manning's method of operating was, in large part, that he had only been with Manning seven months when he swore the affidavit, and believed it to be true at the time.

We asked Schwalb a number of questions about the affidavit, and in our view some of the answers given were disingenuous. We could not accept them. We concluded that Schwalb, then being a new employee of Manning, had probably bent over backward to say nice things about Manning in the affidavit, and now was reluctant to admit that he had done so. But despite the fact that Schwalb was complementary to Manning in the affidavit, and far from complementary in his evidence at the hearing, most of what he told us in his evidence was not directly contradicted by anything which he had said in the affidavit, and we found it to be believable. In addition it was consistent with the evidence of the other Inside Witnesses, as well as the evidence of the former Manning customers.

#### *Darling*

Darling was employed by Manning from March 1994 until March 1995, for the first two months as a Qualifier and for the last 10 months as an Opener. He said that he left Manning because "I got fed up. There was no law and order. It was the attitude was very negative. It was just taxing, it was terrible, I hated it there. I got fed up and I just said I am going".

#### *Gray*

Gray was employed by Manning prior to March 1993 and remained in its employment until April of 1995. He was a Qualifier for the first month and a half or so, and then an Opener.

#### **Former Manning Customers**

##### *Krueger*

Krueger is a 60 year old semi-retired farmer. Before dealing with Manning, he had some experience in dealing with commodity futures, mostly corn and soybeans, but no experience at all in the stock market. When he first started dealing with Manning, his annual income was between \$40,000 and \$50,000, and his net worth was approximately \$800,000. He was sold by Manning a total of approximately \$75,000 in highly speculative shares. These came out of Manning's inventory, and now have a value of less than \$5,000.

Mr. Lenczner, referring to Krueger, said "And once again, over a period of three years with this man buying and selling stocks, can it really be suggested that he was pressured or under the gun?". As to when Manning permitted a customer to resell shares we will say more later in these Reasons. Krueger's evidence convinced us that he was in fact pressured and under the gun.

*Nageleisen*

Nageleisen is a 38 year old public school teacher who resides on Pelee Island and teaches grades four through eight in a small school on the island. Her annual income is approximately \$50,000 a year, and her husband, who works as a deckhand on the Pelee Island Ferry, earns approximately \$15,000 a year. Their net worth is about \$150,000. In addition, when she first started to deal with Manning, her parents had recently given her \$52,000 to help with the prospective construction of a new house on land owned by her and her husband. Prior to dealing with Manning, she had never traded in stocks of any kind. She was sold approximately \$50,000 of highly speculative shares by Manning. These shares came out of Manning's inventory, and now have little or no value.

Mr. Lenczner produced to us Manning's file on Nageleisen, and pointed out to us that some of the internal Manning purchase tickets in that file were marked "unsolicited trade". He suggested that this proved that Nageleisen was not subject to high pressure sales tactics. On the evidence, it seems clear to us that all of Manning's sales to Nageleisen were in fact solicited by Manning, and that the purchase tickets are unreliable in this regard. The phrase "unsolicited order" did not appear on the confirmation slip which went to Nageleisen. This is, in our view, another instance of the impropriety of making this sort of allegation without being prepared to produce a witness who was expected to back it up. Rather than Nageleisen being an avid purchaser, as suggested by Mr. Lenczner, we were satisfied from her evidence that she purchased from Manning because she, having no prior experience, was subjected to high pressure sales tactics by Elik and others at Manning.

*Normoyle*

Normoyle is 38 years of age. He owns a small construction company which operates out of Ottawa. When he first started dealing with Manning, his annual income was approximately \$55,000, and his net worth approximately \$400,000. He had only made one investment, an unsuccessful one in a resource stock. He was sold by Manning approximately \$34,000 of highly speculative shares, which came out of Manning's inventory. All his stocks were eventually "sold" by Manning after he faxed Manning explicit market orders (requiring a sale at whatever the market happened to be) on all of his holdings several times. He lost about \$15,000 of his investment.

*Dritsas*

Dritsas is 43 years of age. He is the owner of a refrigeration and air conditioning business in Hamilton. During the relevant period, he also owned a Mr. Submarine franchise in Burlington. His annual income was in excess of \$50,000, and his net worth was in excess of \$100,000, when he commenced to deal with Manning. Prior to dealing with Manning, his only investment experience involved a small investment in a mining company, made with his brothers in 1970 or 1971. He was sold approximately \$13,000 of highly

speculative shares by Manning out of its inventory. These have little or no value to-day.

*Sisson*

Sisson is 37 years of age. He is a Professional Engineer, employed by Honeywell, earning approximately \$50,000 per annum. He has a net worth of approximately \$70,000. Prior to dealing with Manning, he had never invested in shares of public companies. Manning sold him approximately \$23,000 of highly speculative shares out of its inventory. These shares have little or no value to-day.

*Balter*

Balter is 73 years of age. When he commenced to deal with Manning, he operated a small and not very profitable dealership selling cemetery monuments. Prior to dealing with Manning, he had made one stock investment, some 12 or 15 years before. When he commenced to deal with Manning, he had little or no net worth. His wife had an annual income of under \$20,000, and he was in receipt of some pension income. Over the period of his dealings with Manning, he was sold over \$113,000 of highly speculative shares by Manning out of its inventory. However, unlike most of the other former Manning customers, he was permitted by Manning to resell almost \$50,000 of these shares from time to time. This seems to have been because, when he became concerned about the amount which he had at risk with Manning, he was told by an acquaintance in the securities business to see whether he would be able to sell any of the shares, and so advised Elik. He was from time to time thereafter permitted to sell shares. However, the proceeds and more were concurrently or soon thereafter applied to pay for further sales made to him by Manning.

To pay for the shares sold to him by Manning, he used the working capital of his business, supplied by his bank under a line of credit which was secured by collateral pledged to the bank by his children. When the bank loan had to be reduced, loans were made to him by his children for this purpose. Balter lost almost \$64,000 on the securities sold to him by Manning.

Mr. Lenczner described Balter as a man who was "in the market in March of '92 virtually on a daily basis, buying and selling, buying and selling, making a profit", asked "Is this a man who can't get his stocks sold?", and asked that, when Balter came before us, we listen to his evidence carefully when he told us that he did not know what he was doing. We did listen carefully, and concluded that Balter was an innocent who was played carefully by Elik and others at Manning to extract from him everything which he was able to borrow to buy shares from Manning.

*Moor*

Moor is 47 years of age and resides in Magnetawan. He is a teacher who works with disturbed children at bush camps. When he began to deal with Manning, he had an annual income of approximately \$65,000 and a net worth of approximately \$200,000. He had never been involved in the



stock market. He was sold something under \$20,000 of highly speculative shares by Manning out of its inventory. To-day, these have an approximate value of \$3,000.

*Jarvis*

Jarvis is 37 years of age. Until recently he was the general manager of a graphic design company, and is now a freelance consultant in graphics design management. When he commenced to deal with Manning he had a net worth of \$150-160,000, and an annual income of approximately \$75,000 plus a profit sharing from his employer. His only prior experience with investing in unlisted stocks was in a company which was a client and with which he was familiar, although he did trade quite actively in listed securities through Midland Walwyn. He was sold over \$19,000 of highly speculative shares by Manning out of its inventory. To-day, these shares have little or no value.

*Estephan*

Estephan is 36 years of age and is a consulting professional engineer. When he commenced to deal with Manning, his annual income was approximately \$42,000 and his net worth was approximately \$100,000. He had never purchased any stocks before. He was sold over \$6,000 of highly speculative shares by Manning out of its inventory. These shares have little or no value to-day.

*Bray*

Bray is 48 years of age. He is a lawyer living and practicing in Sudbury, having a general practice, with emphasis on litigation. When he commenced to deal with Manning, he had an annual income in excess of \$250,000, and a net worth of \$400-500,000. He dealt with a broker, and had a stock portfolio of \$5-10,000. Bray was sold approximately \$16,000 of highly speculative shares by Manning out of its inventory, and lost approximately \$13,000.

Unlike most of the other former Manning customers, Bray cannot be described as inexperienced or naive. Rather he is an experienced lawyer, with some prior share investment experience. We were interested to try to understand just how he came to make the purchases which he did from Manning and to continue to deal with Manning after he began to realize that he was in trouble. A number of statements which he made go a long way to explaining the reason.

"I mean, there is a facade, or at least an assumption of honesty, an assumption that these are people that are doing business in Ontario, they have a name, they call you regularly. They must be okay. They must be regulated like everyone else is. They couldn't be just giving you all this garbage."

"I didn't think that people could do business like this and get away with it. Doctors are regulated, lawyers are regulated, your mechanic is regulated."

"Nobody told me I'd have a problem with selling, and nobody--nobody warned me that you're so trapped, you just feel like you're forced to deal with them, because who else can help you sell--can help you get some of your money back?"

In explaining why he had volunteered to testify, Bray said:

"Well, you know what, sir, I decided that if I was embarrassed and ashamed, that they play on that kind of stuff, so I decided that I would put my tail between my legs and come here and confess to naivety and stupidity and lacking in judgment and perspective and all those bad qualities, in hopes that this kind of thing won't happen to other people."

*Zaccaganini*

Zaccaganini is 36 years of age. He lives in Windsor and is employed as a mechanic by General Chemical. He also owns a small company which repairs, buys and sells cars. Prior to commencing to deal with Manning he had no stock investment experience, a net worth of \$200-225,000 and annual income of around \$50,000 from his employment. His gross income from his auto repair business was about \$90,000. He was sold approximately \$80,000 of highly speculative shares by Manning out of its inventory. To-day, these have little value.

*Webb*

Webb is 47 years of age. In 1973, he found out that he had multiple sclerosis. Since then, his health has deteriorated, and he is physically disabled, not having worked since 1975. His income, from a disability pension, is approximately \$900 per month. Webb was sold approximately \$35,000 of highly speculative securities by Manning out of its inventory.

Webb is unable to write quickly. As a result, he regularly tapes telephone conversations when he believes that information will be provided that he might need at a later date. Many of his conversations with Manning officers and employees were taped by him. Not all were retained since once a conversation was taped he reviewed it and often made notes of the conversation, following which the tape might be re-used. We were supplied with copies of these notes, and heard those tapes which remained of the conversations. We were also supplied with transcripts of these tapes. It was made clear to us that the tapes which we heard did not represent all of the relevant conversations and that a tape of a particular conversation might not include all of the conversation because of the possible overrecording of a part of the conversation which resulted from a re-use of the tape. However, we were satisfied that we could safely rely on what we heard as representing what had been said by officers and employees of Manning in telephone conversations with Webb.

As we have indicated above, it is one thing to be told by a witness what was said to him, and that high pressure was employed by Manning representatives. It is another thing to

hear the high pressure in action, to not only hear precisely what was said, but also the manner in which it was said. Hearing these tapes gave us a much better understanding of what was told to us by the other witnesses, and of the selling methods used by Manning personnel.

To complete the Webb story, after months of demanding to be compensated by Manning for his losses, Webb complained to the Staff and told Manning that he had done so and that he had the tapes. A handwritten note, dated November 22, 1993, in the file of documents relating to Webb supplied to the Staff by Manning reads as follows:

"Walter Dixon called wanting to speak to Doug [presumably Elik]. Says that Doug Webb has taped every conversation with us and he, Dixon, feels that the know your client form is not being adhered to. "I was shocked when I saw that you had laid 35,000 of speculative stocks on him, especially as he is disabled, in a wheelchair and earning \$7,000 pa. It would look very bad in a court of law. He Dixon says its not his concern but feels Mr. Elik should be aware as Webb will be believe take it further [sic]."

In the same file, there is a copy of a letter dated February 21, 1994 from John A. Eversley, a barrister and solicitor, to Webb, which includes the following.

"Further review of your file indicates that, over a period of months, a significant amount of various securities of a relatively speculative nature were assembled in your account.

I am of the view that securities of that type are not suitable investments for a person in your economic circumstances and that they should not have been either recommended or sold to you."

Webb's losses were refunded to him by Manning.

When Webb approached the Staff, he spoke to John Aiken. Mr. Aiken is 78 years of age, has been in the securities business for 63 years (with a break for service in the Royal Canadian Air Force), spent most of his career as a broker and floor trader with member firms of The Toronto Stock Exchange, and during the latter part of his career was part of the market surveillance group of the Exchange. He joined the Staff in 1987 as a contract employee in the Enforcement Branch. He is currently an investigator in the Inquiry Section of the Branch. Part of his job is to field complaints made by members of the public.

Webb explained his position and problem to Aiken, and Aiken spoke to Webb from time to time, and visited him, to assist Webb and obtain information from him. In a telephone conversation which took place on January 25, 1994, Aiken asked Webb to erase any tapes which Webb had of conversations with Aiken. Aiken stated his concern that he

might have said something against Manning, and that this could involve him in court proceedings.

Mr Lenczner pointed out this request, and argued that it supported his assertion that the Staff had "approached this whole task with a zeal to justify exactly what they started out to do in 1990 when they tried to get Policy 110[sic] in. They haven't been impartial. They want all of the securities dealers off the street and they have set about to investigate it with that in mind and to take all of these witnesses and use the parts that are available to them, and have been reluctant to assist my client in any way."

There is no doubt in our minds that Aiken should not have asked Webb to erase any tapes, no matter how much Aiken might have feared a lawsuit by Manning. However, we can understand completely why Aiken, after hearing Webb's story, might have approached with zeal the task of assisting him, and, indeed, the task of helping to put together a case against Manning. We will deal further with Mr. Lenczner's allegations of impropriety against the Staff later in these Reasons.

#### *Believability of Former Manning Customers*

It was obvious to us that the former Manning customers who gave evidence were angry at Manning and its representatives, and that some of them were glad to be able to give evidence against Manning and its representatives. But this in no way called into question their credibility. The decision of the Director of the Commission in *In the Matter of Adelaide Securities Limited* (1968), O.S.C.B. Vol.3 p.57 at 76 states the position as follows.

"It is perfectly true that many of these people spoke from anger and, it might be argued, with motives of revenge. The vehemence with which a complaint was made may also argue the truth and sincerity of the complainant. Their anger in calling for the person responsible to account does not of itself destroy a belief in the honesty or sincerity of the complaints that they had been deceived. Whether one believes one or more of these purchasers to be stupid or naive, gullible or greedy, this does not make them fair game for the party who seeks them out."

We agree with this statement.

#### **The Cast of Characters**

##### *Manning*

Manning was, at all times material to these proceedings, registered with the Commission as a securities dealer pursuant to section 26 of the Act.

##### *Judith Manning*

Judith Manning was at all material times the President, Secretary and Treasurer of Manning and registered with the

Commission as an officer and director of Manning. From the evidence it is clear that she played an active role in the management of Manning, acquiring the positions for inventory which Manning marketed to the public, deciding which Loader would be responsible for selling stock to a particular customer, and playing the role of the "Cooler" par excellence i.e. when a customer's complaints rose to the level at which no one else could convince the customer that the customer himself or herself was responsible for the losses suffered by the customer, Judith Manning would take on the job. According to the evidence of Schwalb:

"From my observation Mrs. Manning just overlooked everything. Put the deals together, handed out client accounts to loaders. She really, she was the president hands-on and she did everything and watched everything."

#### *Elik*

Elik, at all material times, was a Vice President of Manning and its Sales Manager and was registered with the Commission as an officer and director of Manning. He and Ted Manning played primary roles in training Manning employees to carry on its business in the manner in which it was carried on. As well, they were the principal Loaders, actively engaged in selling amazingly large amounts of highly speculative shares to Manning customers. From the evidence, and as reflected in the Webb tapes, it is clear that Elik is a super-salesman, prepared to say whatever is necessary to sell product to the customer or to prevent the customer from reselling the shares.

#### *Ted Manning*

Ted Manning is a son of Judith Manning and was, at all material times, registered with the Commission as a salesperson at Manning. In fact, he played a much larger role than that of a mere salesman. Like Elik, Ted Manning is a super-salesman, who showed little regard for the truth when engaged in selling Manning product to customers or convincing them that they should hold on to it even when its price was dropping.

#### *Fritz*

Fritz is a daughter of Judith Manning. She was, at all material times, a Vice President of Manning, registered with the Commission as an officer and director of Manning. She was Manning's compliance officer. As Manning's compliance officer, she had a special obligation to ensure that its business was carried on in accordance with the requirements of Ontario securities law. From the evidence, it is clear to us that she made no attempt to do so, and in fact was an integral part of the management group that was responsible for the manner in which Manning in fact carried on its business.

#### *Bolton*

Bolton was, at all material times, registered with the Commission as a salesperson of Manning. She played the role

of the guardian at Elik's gate, to a considerable extent insulating him from irate customers so that he could get on with his principal activity of selling shares. In addition, she also played the role of a "Cooler", convincing customers that they should not insist on reselling their shares either to make a profit at the expense of Manning or when the shares were dropping in price.

#### *Finance*

Finance was, at all material times, registered with the Commission as a salesperson of Manning, and was an assistant sales manager of Manning. He also acted as an Opener. From the evidence it would appear that he engaged actively in selling highly speculative shares to Manning customers using the high pressure sales tactics that were part of its stock in trade. He was also involved in training prospective Openers. It appears, however, that he did not play as significant a role in Manning's operations as did the other individual Respondents.

#### *Prior Proceedings*

The Commission's registration files disclose no prior orders by the Commission against any of the Respondents.

#### *The Manning Product*

Manning cannot be described as a dealer in securities in any normal sense of the word. It did not, in the normal course, act for its customers in the purchase and sale of securities generally, either acquiring for the customer securities which the customer desired to purchase or considering the customer's circumstances and means and recommending appropriate securities to the customer for purchase or sale.

Rather, it acquired (generally itself but on occasion together with another securities dealer) a sufficient position in the outstanding shares of a small issuer to effectively give it control over the market for the securities of that issuer. These shares would have little intrinsic value. So far as we were able to tell from the evidence, none of these shares would be listed on a stock exchange. After its purchase, Manning would effectively represent the only market for the purchase and sale of the shares, enabling it to set the price at which the shares would be sold or repurchased. It did set the selling price, at a very substantial mark-up from its cost, moving the selling price to customers gradually up until its inventory had been disposed of, and then letting it drop. The evidence indicates that on occasion the process would be repeated more than once. Manning discouraged its customers from reselling the shares, since in reality it would be the only purchaser and its goal was to get rid of its inventory, not to increase it. At the end of the day the customer would be left with shares which had little or no value, and for which there was no real market.

Balter, in his testimony, described the position as follows.

"I perceive that it is involved in a risk, but a risk like anything, a man is getting married is also a risk. Everything in life is a risk, because we can't figure out what is going to be. You buy shares of a company, the company is losing money, this is a risk which happens. But here it was not a risk, here was just, and this I did not contemplate, here was just swindle."

The evidence fully supported this assessment. We have, in these Reasons, described the shares sold by Manning as "highly speculative shares". In truth, this description is too complementary. The word "speculative" imports the possibility of profit, even if this may be remote. From the evidence, it is clear to us that Manning never intended to permit its customers to make a profit, and there was no evidence before us that any did.

### **The Manning Selling Scheme**

The Manning sales structure consisted of a three level telephone sales force, Qualifiers, Openers and Loaders.

#### *Qualifiers*

Qualifiers were non-registrants whose function was to cold-call members of the public in order to secure them as leads for the next level of the sales force. The evidence of the Inside Witnesses was that the persons called would be selected by the qualifiers from the yellow pages of local telephone directories from across the province or from lists otherwise obtained. Each qualifier was expected to make about 200 calls a day and, reading from a prepared script, ask the prospect whether he or she would like to receive the Manning Letter. If the prospect agreed, he or she would be told that there would be a follow-up call from a Manning salesperson in a couple of months if a good investment opportunity became available. If the prospect did not object to this, he or she would be considered as a lead to be passed on for further contact. The qualifiers were located in Manning's telemarketing department.

#### *The Manning Letter*

The Manning Letter was an impressive publication, giving information as to general economic and market matters. Significantly, however, it did not give information as to the products which Manning in fact sold. Manning did not have a research department, and it would appear that the publication was prepared for Manning by a third party. In our view, the publication was clearly intended to give the impression that Manning was a full service dealer like all other full service dealers, rather than a selling organization selling, basically, only shares from its inventory.

#### *Openers*

Openers were registrants to whom leads obtained by Qualifiers were passed on. Their function was to make the initial sale of a Manning product to a prospect. They were trained by Manning to do so using extremely high pressure tactics, and without any regard to the needs or circumstances of the prospect. They were given very little information about the issuers the shares of which they were selling, and were told to "sell the sizzle, not the steak", that is not to discuss the specifics of the issuers involved, but rather to sell themselves and play on the greed of the customers and their fear of missing a good thing. Openers were taught to use the "two strokes, money" approach, that is to say two things about themselves or the product, and then ask for money. If the prospect resisted, the technique would be repeated again and again until a sale was made or the Opener was convinced that no sale was possible. They were also trained to slip into their discussion with the prospect the fact that there was a risk involved in the investment, as with any investment, while downplaying the possibility of the risk occurring and playing up the virtual certainty of a substantial profit within a specified period, and also to slip in the fact that the sale was a principal one (i.e. a sale from inventory) without in any way describing what a principal sale was. As well, they were trained to stampede the prospect into making an immediate purchase so as to take advantage of the current price, stating that the price was going to move up in the immediate future. Part of their training also included the way to fill in a "know your client" form to state that risk, and the fact that the sale was a principal (usually spelled by the Openers "principle") sale, had been disclosed to the customer and that the customer's investment objectives (in more recent forms described as the objective with Manning) were entirely or mainly "venture situations". Elik and Ted Manning played significant parts in this training process. Finance also played a part. Another part of the training process involved listening to Openers talking to prospects, so as to learn how to sell in the Manning manner.

The basic sales technique was to advise the prospect that the Opener wanted him or her as a customer, had a special investment opportunity available which would be so profitable that it would convince the prospect by its success that he or she should become a continuing customer of the Opener, and that the prospect would be able to rely on the Opener to tell the prospect when to sell for a profit. The prospect was told that a long term relationship between the prospect and the Opener was what was intended. In fact, if a sale was made to the prospect by the Opener, and once the prospect paid for the initial purchase, the prospect would be passed on to a Loader, and in the normal course would never hear from the Opener again.

Openers had to fill in "know your client" forms, but were, as above indicated, taught how to do so in a manner which would provide maximum protection to Manning, without too much concern for the accuracy of the information contained. The forms would not be filled out until after the initial sale was made, and the information contained in them played no part in determining what customers would be sold. They would be sold whatever product Manning was then selling.

The Opener was paid by Manning a commission, normally 17 1/2 percent, of the total cost to the customer of the shares sold to the customer by the Opener. However, if the customer should sell the shares back to Manning within 90 days (which, as discussed below, was not easy to do), the commission would be recaptured by Manning. No commission was paid to the Opener by Manning on a resale by the customer, and no commission was paid to the Opener by Manning on a purchase by the customer of any securities other than Manning product sold by Manning out of its inventory.

#### Loaders

After the initial sale to the customer, the customer's file would be passed on to Judith Manning, who selected the Loader who would thereafter primarily deal with the customer, and passed the file on to this Loader. The Loaders had two principal functions. The first function was to get the customer to buy as much of the Manning products as possible, using extremely high pressure tactics and without regard for the customer's needs or circumstances. Examples of these high pressure tactics will be described below in these Reasons. When the original Loader had sold the customer as much stock as the customer was prepared to buy from him, the customer's card would often be passed on to another Loader to see whether the latter could sell the customer additional shares. The second function was, except in connection with switches from one Manning product to another, to convince the customer not to attempt to resell the products so purchased. Since, for practical purposes, Manning would be the only buyer on a resale, Manning had every reason to discourage resales. Its interest was in getting rid of its inventory, not in increasing it at a price which would give the customer a profit or even permit him or her to break even. Elik and Ted Manning were Loaders, and very expert Loaders. It is clear from the evidence that they were prepared to say anything, without an excessive regard for the truth, to carry on their loading function.

Loaders were also paid by Manning a commission, normally 17 1/2 percent, which they split with the Opener who made the initial sale to the customer.

#### "Cooling"

As above stated, one of the primary roles of Loaders was to attempt to ensure that customers did not resell product purchased by them. Bolton and, to some extent, Judith Manning also played a role in this regard. Bolton, was Elik's assistant and also assisted Ted Manning. One of her major roles was to insulate Elik and Ted Manning from irate customers who wanted to talk to them to complain about the falling prices of their shares and/or to instruct them to sell shares either for a profit or when the price of the shares was dropping. Another of her functions was to "cool" the customers, that is to calm them down and talk them out of selling their shares or, at least, to delay them until Elik or Ted Manning chose to get back to them to continue and complete the cooling process.

The principal method of cooling was to convince the customer that the price of the shares was going to continue to go up or would go back up, if it had fallen. Again, Elik, Ted Manning and Bolton were not scrupulous with the truth in so doing. If this failed and the customer insisted on selling, the customer's sell order would normally either not be processed or would be put in at or above the ask price rather than at market or at the bid price, so that the customer could be told that his or her specified selling price had not been able to be obtained. In the result, the customer would not normally be permitted to sell his or her shares except where the shares were being switched for other Manning product for a higher aggregate purchase price or the customer knew enough to insist that the shares be put in for sale at market and gave specific written instructions to do so, and could not be talked out of it.

#### Boiler Room Operation

The Staff's allegations, and the evidence adduced by the Staff, raised a number of questions which we had to decide before being able to determine whether the Respondents' activities were such as to give rise to the exercise of the Commission's clause 127(1) 1. and 3. powers. Among these were whether the Respondents were engaged in a Boiler Room activity, and, if they were, whether this alone, apart from any other matters involved in the Staff's complaint, should give rise to the exercise by us of these powers.

Mr. Douglas, on behalf of the Staff, referred us to the decision of Judge Fulton of the United States District Court for the Southern District of Florida in *Securities and Exchange Commission v. R.J. Allen & Associates, Inc., et al* [1974 Transfer Binder] CCH Fed. Sec. L. Rep. Para. 94,920 at page 97,154 as giving a widely accepted definition of what constitutes "Boiler Room" activity, as follows:

"'Boiler Room' activity consists essentially of offering to customers securities of certain issuers in large volume by means of an intensive selling campaign through numerous salesmen by telephone or direct mail, without regard to the suitability to the needs of the customer, in such a manner as to induce a hasty decision to buy the security being offered without disclosure of the material facts about the issuer."

We accept this definition as an appropriate one for the purposes of these proceedings.

Implicit in a boiler room operation is a failure to observe the "know your client" and "suitability" rules set out in section 114 of the Regulation. The relevant subsections of that section read as follows.

"(1) Every registered dealer and adviser shall establish procedures for dealing with its clients that confirm with prudent business practice and that enable it to service its clients adequately and shall take whatever steps are necessary or

appropriate to supervise such procedures properly.

(3) The procedures referred to in subsection (1) shall be in writing and designate a partner or director or, in the case of a branch office, a manager reporting directly to the designated partner or director, who shall be responsible for approving the opening of new accounts and the supervision of trades made for or to that client.

(4) For the purposes of subsection (1), but without limiting the requirements of that subsection and subject to subsection (7), each dealer, investment counsel and portfolio manager shall make such enquiries as,

- (a) will enable it to establish the identity and, where applicable, the credit worthiness of each client, and the reputation of the client if information known to the dealer, investment counsel or portfolio manager, causes doubt as to whether the client is of good reputation; and
- (b) subject to subsection (5), are appropriate in view of the nature of the client's investment and of the type of transaction being effected for its account, as to the general investment needs and objectives of each client and the suitability of a proposed purchase or sale for that client."

Also implicit in a boiler room operation is a failure to observe the obligation of a registrant to deal fairly, honestly and in good faith with its customers, which obligation the Commission has long considered to be one which a registrant must be considered to assume with a registration under the Act.

We have no difficulty in finding that for a registrant under the Act to carry on a Boiler Room operation in the Province of Ontario is contrary to the public interest and fully justifies the Commission in exercising its clause 127(1) 1. and

3. powers. We agree fully with the Staff's contention that the investing public in the Province of Ontario, and the Commission, have, and are entitled to have, a reasonable expectation that Ontario registrants will not ignore the questions of suitability and appropriateness of a proposed investment to and for the client, and will not peddle inappropriate securities to clients by use of high pressure selling tactics designed to induce, and having the effect of inducing, clients to purchase securities inappropriate to their situation on the basis of inadequate investment information and/or misinformation as to the issuers of the securities, the value of the securities and the prospects of the issuer and the securities. Such a holding is essential to the integrity of the capital markets of Ontario, and to the credibility of those markets. It is also necessary for the protection of the investing public.

This holding should not be a surprise to the Respondents. It is consistent with and supported by decisions of the Commission going back at least as far as 1952.

*In Malvern Trading Corporation Limited-Broker-Dealer* (1952), O.S.C.B. Vol.4 p.1, the Chairman of the Commission stated as follows.

"An audit of the records of Malvern Trading Corporation Limited discloses consistent re-loading in the course of the distribution of a highly speculative oil issue, but the story disclosed by these records and by an admission under oath, is not merely a story of the salesman or salesmen finding an easy mark and selling the customers by repeated calls to the last dollar. In this promotional house the matter was placed on a higher plane. When a salesman had sold and re-loaded a customer to the best of his ability, the account was taken away from him and handed to a super salesman in order to add the finishing touches. This is a practice which no doubt was prevalent at one time, but seems to have disappeared to a large extent. The super salesman in this instance who was afforded the privilege of re-loading customers originally contacted by his fellow salesmen was Griffin. But Griffin is not a super salesman - his success in this operation is attributable to the fact that he enlisted the services of one, Kaufman, whose unfavourable record is internationally known and who could never hope to obtain registration in Ontario. Kaufman was then the real super salesman who victimized his own fellow countrymen in the United States by continuing to sell them a highly speculative issue beyond reason or beyond their means. Griffin and Kaufman then split commissions. Griffin denies that Caldough knew of this arrangement and although common sense dictates that Caldough did know of the arrangement, I am unable to make a finding to this effect. However, this is immaterial. The methods employed by Caldough warrant cancellation regardless of his

knowledge or lack of knowledge of the exact details of how these sales were effected. He was aware of the results and must accept the consequences, which are attributable to his accepted policy of extracting the last possible dollar."

On appeal of the Chairman's decision ((1952), O.S.C.B. Vol.4 p. 6), the Commission stated as follows.

"When the small number of inquiries received in response to the initial public offering made through the mail by Malvern and the still much smaller number of sales resulting from these inquiries are considered in relation to the number of telephone calls made by Malvern in sponsoring this speculative issue, Malvern may be fairly classified as a boiler-room. The extent of the telephoning is clearly attributable to repeated and persistent calls on original subscribers in order to induce them to speculate further, regardless of the extent of their holdings at the time. The fact that customers were handed over to another salesman after the first salesman considered the account had been sold to the limit, should in itself be accepted as conclusive proof of the nature of Malvern's operations.

The records further reveal that Malvern devoted its efforts mainly to selling in the United States, contrary to the policy of the Commission dating back to 1948, to the effect that registration should not be granted in this Province mainly for the purpose of selling securities in the United States in contravention of the securities laws of that Country. It now appears that Malvern could not have survived except by ignoring this policy and without resorting to high-pressured methods.

The explanation offered as to why other salesmen's accounts were handed over to Griffin, to the effect that when Griffin joined Malvern they were no new accounts to be assigned to him, is not only inconsistent with other sworn testimony given in the course of this investigation, but it is inconsistent with the facts. The explanation might be accepted if this situation prevailed only during the early stages of Griffin's employment, but it continued for over four months at least, according to our records which were compiled some four months ago and which are not necessarily complete.

During the hearing Mr. Caldough assumed the role of an expert witness, purporting to give evidence concerning conditions prevailing in the brokerage industry respecting the matters under consideration, and comparing his activities favourably with others in the promotional field.

In short, he relied on the time-worn defence that everyone is doing it, and so placed himself in the same category as the fly-by-night operators who are guided solely by the principle of "sell to the limit as long as your registration lasts."

In view of these facts it is not necessary to consider other items considered in the Chairman's decision, or dealt with during the hearing."

In *Harold David Reynolds-Salesman* (1965), July-August O.S.C.B. 1, the Commission stated as follows.

"In the sale of securities of this nature, a responsible securities' salesman should point out the speculative aspects of the security. To create the impression that a security will attain a guaranteed value is a breach of the standard of responsible conduct.

A registrant, who does not maintain that standard, cannot expect to have his registration continued. The Applicant submits that he has paid for his misconduct by reason of these proceedings, and should be given another chance to earn a livelihood as a security salesman. In effect, the Applicant is suggesting that only a suspension should be imposed as a penalty. But, having demonstrated by his actions that he does not appreciate the basic standard required of a registrant, it is necessary in the public interest to cancel his registration."

In *In the Matter of Goldmack Securities Corporation Limited* (1966), January O.S.C.B. 14, the Commission, dealing with the ethical standards expected of registrants, said the following.

"It must be borne in mind by all registrants that in dealing with the public they cannot assume that the public is knowledgeable and sophisticated. The Securities and Exchange Commission has given a helpful guide on this point in its decision in the case of *The Private Investment Fund for Governmental Personnel*, 37 S.E.C. 484, where it stated:

"We must give due recognition, as have the courts, to the fact that 'the investing and usually naive public need special protection in this specialized field,' and must take into account the effect which the [representation] may have not only on the sophisticated and informed investor, but also on the unwary and the ignorant."

Nor are we in these cases concerned only with criminal or civil fraud. By seeking and holding

registration a registrant in fact represents that he will deal fairly with the public. The securities business has been long considered as requiring special regulation. While we have few reported cases on this point in Canada, this basic principle has been enunciated clearly in many American judgments. The case of *Charles Hughes & Co. Inc. v. SEC*, 139 F. 2d 434, is in point. The Court therein stated:

"We need not stop to decide, however, how far common-law fraud was shown. For the business of selling investment securities has been considered one peculiarly in need of regulation for the protection of the investor... The essential objective of securities legislation conditions from the over-reaching of those who do."

The facts of the present case display a form of over-reaching in which a registrant should not engage. The registrants' ethics in this matter are questionable, to say the least."

In *In the Matter of Adelaide Securities Limited* (1986), O.S.C.B. Vol.3 p. 57, the Director of the Commission said the following at p. 60:

"With variations in specific detail a thread runs through the complaints. They all were lead [sic] to believe that the prices at which they were offered shares represented the public market prices of the shares. They were lead [sic] to believe that the price of the shares had risen, was rising or was about to rise. They did not understand the term "offering price". They did not realize that the price at which Adelaide was selling shares bore no relationship to the price at which Adelaide was willing to pay for shares. They did not understand that Adelaide was the only purchaser for the stock, apart from the people to whom it sold. On learning there was no bid for the stock by anyone, including Adelaide, at prices at or near the selling price the purchasers felt they had been defrauded."

At p. 62, he said the following:

"Adelaide's reason for existence is to merchandise the securities it has purchased at what may be viewed as wholesale prices from the treasuries of the companies promoted by Messrs. Lindzon and Lindover. On rare occasions Adelaide has acted as an agent in the sale of securities other than those owned or optioned directly or indirectly by its principals.

The techniques used to merchandise these stocks followed a pattern common to many broker-dealers. First promotional literature is sent to the prospect. An initial offering price is given. A maximum offering price, or in other terms a maximum retail price at which the shares may be offered, is fixed as a matter of law by The Broker-Dealers' Association of Ontario. Adelaide is a member of B.D.A. Stock purchased from the company at 10¢ per share may be sold for as much as 30¢ per share. (This is one of the several matters presently being studied by the Committee chaired by Commissioner D.S. Beatty.) It was noted that the offering price was moved upwards from time to time, in relatively small step-ups giving the regular reader the impression that the shares were rising in price. In all of the issues we considered the only relationship I could find between the increased offering prices and the merits of the issue was that as the company received progressively more for its shares, e.g. 12 1/2¢ and 15¢, the maximum offering price or ceiling would also rise, e.g. 35¢ and 45¢.

The promotional literature then is followed by telephone calls. Each of the eight complainants made their purchases as the result of such calls. When a promotional campaign was underway Adelaide assembled a group of ten or more telephone salesmen to work on the current deal. These salesmen are paid a commission on each sale provided the purchaser retains the securities for a minimum period of time. The salesmen transfer freely from broker-dealer to broker-dealer as deals come along.

While we did not explore this with Adelaide, and their literature indicates that as one sales campaign was being phased out the next one was being phased in, there are usually lulls between deals during which the next promotion is being assembled, the mail campaign developed leading to the telephone sales campaign. Promotional broker-dealers such as Adelaide are commonly known to the securities industry and to the more sophisticated segment of the public as "boiler shops".

Before turning in details to the evidence the principle I applied to the evidence was most simply stated by the Commission in Re Goldmack Securities Corporation Limited January, 1966 O.S.C.B. at page 18, as follows:

"By seeking and holding registration a registrant in fact represents that he will deal fairly with the public."



At p. 70, the Director said the following:

"Mr. Lindzon told how the initial sale would be developed by suggesting to the prospect that the purchase be used as a yard stick or guide as to whether to do further business with Adelaide. (Some of the complainants stated they were told by the salesman that Adelaide would advise them when to sell.) Their desire to make profit for the prospect was immediately established. An initial purchase of 1,000 or 2,000 shares would be suggested. However, a lesser amount was acceptable. Mr. Lindzon rejected any suggestion that his salesman represented that the price of the highly speculative shares they were selling had risen, was rising or would rise. He emphasized and repeated a key phrase. It was to the effect that predicated on good field results the stock could enhance in value. The words were carefully chosen and orally underlined.

In response to questions designed to determine what concern Adelaide had as to the knowledge and experience of the prospect, the suitability of this speculation for him, and other factors which might influence the kind of advice a broker might give to his client, Mr. Lindzon found this objectionable as an intrusion on the private affairs of the prospect. His business was selling securities, trying to build a sale, and the prospect might resent such questions. His salesmen were instructed to ask the prospect if he could "manage" the purchase. He cited as an illustration an occasion when he spoke to a British Columbia business man as to his ability to purchase 10,000 shares of Rocky Brook Mines Limited at .60¢ per share. Mr. Lindzon concluded that the man wanted to gamble so they confirmed the stock to him.

This man had purchased 5,000 shares of the same stock for \$2,250.00 a short time previously. His affidavit states that he was urged by Mr. Lindzon to purchase the additional 10,000 shares for \$6,000.00 because the stock was going up. Mr. Lindzon pressed him to make the purchase even if it meant borrowing the money. It is a reasonable conclusion that some material inducement caused this man to part with the \$6,000.00. Under the circumstances the balance of credibility would appear to lie with the purchaser.

Mr. Lindzon made it clear in several ways that he felt no responsibility for the customer. His business was marketing securities. In my view, Adelaide's sales techniques were designed to divert the prospect's attention from the real nature of the risk, to create an illusion or appearance of success by associating the

offering in the literature with established companies and by stepping up the offering price from time to time in line with some news from the property which Mr. Lindzon described as "field progress."

The most recent complaint considered was that from a business man from a small Ontario municipality. During the period from mid-April to mid-June, 1967, he purchased 35,000 shares of Vista Mines Limited (the name being changed during this period from Multi-Metals Mines Limited) for some \$18,250.00. These purchases were largely paid for in cash, with someone from Adelaide coming out to pick up the money. Since these sales were made during a period in which Mr. Lindzon knew that Adelaide's fitness for continued registration was actively under review, management's supervision of this account was of particular interest. When questioned about it Mr. Lindzon replied that had this not been a cash account he would have checked further into the purchases. The criterion was obviously the ability to pay.

What then can be considered a reasonable standard of fairly dealing between a broker-dealer and his customers? There may be, as was recently stated in a newspaper article, a class of highly sophisticated speculators in Ontario. With one possible exception, the Toronto area business executive, I did not find them amongst these eight people. It is difficult to believe that a sophisticated investor would have paid \$18,250.00 for shares in a highly speculative venture had he appreciated the nature and quality of the risk. Indeed, the man who evidenced the most caution, the business executive, purchased 1,000 shares for 53¢ each on the representation that the stock was going to sky rocket. He accepted these representations with some reservation. He refused to make a second purchase even though the salesman represented that the shares were going to pass \$1.50. Indeed, when the offering price reached 73¢ he attempted to sell them through Adelaide. Adelaide attempted to persuade him not to sell. The man then sold them through another dealer at 40¢ per share. Adelaide were the purchasers.

The oil company employee from Manitoba found it incredible, even when the moment of truth was long past, that a firm permitted to sell securities should have deliberately deceived him. He accepted the representations made to him with an honest simplicity and faith. After his confidence had been obtained his relatively modest nest egg was dissipated through the ten sales made to him during a two-year period at a cost to him of over \$12,500.00. The farmer from southern Ontario was asked by the salesman to

trust him. He felt that his trust had been misplaced after having been induced to make some six purchases of 8,000 shares of this class of speculative securities at a cost of \$4,900.00 during a three-month period."

At p. 77, the Director said the following:

"Adelaide Securities Limited held themselves out as being in the brokerage business in the sense that most people understand that term. They were not. They were in the business of selling the highly speculative securities which they owned or had under option to the public. They made no attempt to deal fairly with the public. Their only concern with the needs of the prospects was that they were able to pay for, to "manage", the purchase. If the customer attempted to sell, an effort was made to dissuade them so long as the sales campaign was still in progress. The American "know your client" philosophy has no place in the lexicon of this broker-dealer. The promotional literature, the stepped-up offering prices, coupled with the kind of sales talk Mr. Lindzon stated that his telephone salesmen were instructed to give (none of which gave any real disclosure as to the nature and extent of the risk but rather concealed it) constitutes a suppression of material facts. In addition, there are the specific allegations of deceitful high-pressure selling, including the statement alleged to have been made to the British Columbia business man which caused him to part with another \$6,000.00"

He ordered the broker-dealer's registration to be cancelled. We have quoted from this decision at some length because the facts in *Adelaide* bear a striking resemblance to those in this case.

In *In the Matter of Rosmar Corporation Limited et al* (1982), January O.S.C.B. 11C at 30C, the Commission had the following to say.

"As to the breach of the "know your client" rules, the Commission has, on many occasions, stressed the special obligation that is placed on a registrant in dealing with the public. As far back as 1965, the then Chairman of the Commission, J.R. Kimber, in Goldmack Securities Corporation Limited (1966 OSCB 14) made the following statement:

It must be borne in mind by all registrants that in dealing with the public they cannot assume that the public is knowledgeable and sophisticated.

Chairman Kimber then went on to quote approvingly from a judgment of the SEC where it stated:

We must give due recognition, as have the Courts, to the fact that 'the investing and usually naive public needs special protection in this specialised field,' and must take into account the effect which the [representation] may have not only on the sophisticated and informed investor, but also on the unwary and the ignorant.

Most importantly, Chairman Kimber emphasized that the Commission was not concerned only with criminal or civil fraud. He stressed then, as we do again now, "By seeking and holding registration a registrant in fact represents that he will deal fairly with the public. The Securities business has long been considered as requiring special regulations." At the conclusion of his judgment in Goldmack, Chairman Kimber summed up the situation in Ontario as follows:

In Ontario the practice has not been to set down detailed and specific rules to regulate the conduct of the affairs of registrants. The principle adopted has been that there is an implied standard of ethics which applies to all registrants, and it is the responsibility of each registrant to know and observe this standard. This approach permits some leeway and discretion. The industry, I am certain, supports this approach. It may at times, in particular situations, place a registrant in the position where he has to determine personally what is right or wrong without any specific guidelines. In such a situation he must apply the general, ethical philosophy for the conduct of the securities business. The fact that no specific rule prohibits an act cannot be the test.

Section 101 [now section 114 of the Regulation] imposes obligations on every registered dealer that flow from the general "know your client" concept. In the context of the salesmen's conduct here, sub-sections (1) and (4) of Section 101 of the Regulations are particularly relevant."

The Commission went on at p. 32C to say:

"While it is true that Section 101 of the Regulations speaks of the obligation that is on the dealer, which in this case is Rosmar, it nevertheless indicates that one of the main concerns of the Act is with the needs and objectives of the client and the suitability of a propose purchase or sale for each client. This is a matter of which each of the individual salesmen, in view of their long employment as registered representatives, must clearly have been aware. Moreover, it is a central concern of the Manual for Registered Representatives."

"The cases of Rousseau and Engstrom are the most egregious, but the other cases are not much different, and although several of the clients noted above had some experience in dealing in securities, they were basically all unsophisticated and the tactics of each of the registered representatives varied only in matters of degree from the tactics of Eckler in dealing with Rousseau and Engstrom. There was total disregard of the "know your client" ethic. As was said in a somewhat similar context by the then Director of the Commission, H.S. Bray, in Adelaide Securities Limited (1968 OSCB 54):

Whether one believes one or more of these purchasers to be stupid or naive, gullible or greedy, this does not make them fair game for the party who seeks them out.

They [Adelaide Securities] were in the business of selling the highly speculative securities which they owned or had under option to the public. They made no attempt to deal fairly with the public. Their only concern with the needs of the prospects was that they were able to pay for, to 'manage', the purchase.

Those remarks apply exactly to the situation here and to Rosmar, and to each of the registered representatives."

"Counsel asked the question whether there was anything misleading or improper about the way the securities were bought or sold. He emphasized that nobody gave evidence to the effect that the investments were worthless, and Temple and Thunderbolt might well be good stocks. He also noted that nobody said that the salesmen went beyond what was in the prospectus in describing the securities. In counsel's words, they were "selling" the product, and they were entitled to some latitude in their techniques. He added that they were being criticized for "enthusiasm" and that there was no

evidence of misrepresentation. As to "loading", or "overreaching", he noted that one witness had said that he had bought more stock than he wanted. It was true that two witnesses had received confirmation slips for securities that they did not order, but after a discussion they ultimately took the securities, or part of them.

Counsel further noted that no one of the witnesses said that he or she could not afford the stock, or complained about the price paid for the stock, or said that he or she did not want the stock. He emphasized that they were all gambling and they well knew it. He noted that some who sold their stock made money, some lost a little, and some broke even. As to those who still hold Temple and Thunderbolt, they might well be winners yet.

Counsel characterized the salesmen as "hustling" and said that there was nothing wrong with it. He asked whether it was the function of this Commission to stop individuals such as Rousseau from buying penny stock. No government agency would stop them from gambling at the horse races or gambling through purchasing lottery tickets, and similarly the Commission should not be concerned if they wished to speculate in penny stocks.

Counsel's argument on behalf of the Registrants completely ignores the "know your client" rules which have been set out above. The short answer to his argument is that there was a good deal improper about the way the stock was bought and sold in terms of to whom the stock was sold or from whom it was purchased and what those clients were told. As noted above, a special obligation devolves upon those who are registered in this province to sell securities. Securities may not be sold as any other commodity to any willing buyer. The potential for harm to the unwitting, the unsophisticated and the naive, even though they may well be greedy and hope for the return of a quick dollar, calls for the surveillance of securities sales techniques. A witness such as Rousseau or Engstrom does not have to give evidence of "loading" or "overreaching", although there was overloading in both cases. The sale of securities such as Temple and Thunderbolt to such clients is inappropriate. They had no idea what they were buying and they were indeed "hustled" by the "enthusiasm" of Rosmar's salesmen. It is not a case of fraud or misrepresentation, neither of which need be shown for breach of the "know your client" obligation. To quote again from Goldmack, "By seeking and holding registration a registrant in fact represents that he will deal fairly with the public. The securities business has been long considered as requiring special

regulation." The registrants here made no attempt to deal fairly with the public. The sole concern was to sell as much of a speculative security to uninformed clients as they possibly could persuade them to take. In so doing, they did not act in the best interests of their clients."

In *In the Matter of Laurence Aaron Dime* (1986), 9 O.S.C.B. 2678 at 2692, the Commission said the following.

"As we have stated earlier, registrants are required to make out a standard New Client Application Form which provides for an evaluation of the client's objectives as referred to above. Dime told us that since GDG's sole business is the sale of speculative securities, "Venture Situations 100%" was somehow an appropriate designation of the investment objectives of every prospect approached by GDG's salesmen. That argument is ingenuous and we reject it outright. A firm such as GDG, selling to a wide cross-section of unsophisticated investors, is under the highest obligation to ensure that its speculative offerings are suitable for its prospective customers. Dime did not meet that obligation. On the evidence, he made no serious attempt to meet that obligation. For his purposes, every potential customer's investment objectives were "Venture Situations 100%". It is no answer to say that none of the intended customers lost any money. The credibility of the securities markets is damaged - perhaps irrevocably, as to each of the complaints in this case - by conduct such as Dime's."

In *In the Matter of Trend Capital Services Inc. et al* (1992), 15 O.S.C.B. 1711 at 1729, the Commission said the following.

"The result of all of this is that in our view the performance of Trend, of its principals and of its sales persons was wholly deficient. They displayed a total and reckless disregard of any concern whatsoever for the clients to whom the shares were sold. The whole objective was to buy as much stock as possible - on no real knowledge or understanding of Thunder Bumpers - and to turn it over as quickly as possible to unsuspecting customers.

The evidence of several witnesses made it clear that the whole Trend operation was geared to this kind of operation - 16 or more people "telemarketing" or producing lists of "interested persons" with 19 or 20 salespeople mobilized in weekly meetings to canvass the lists produced to find persons to buy these shares. It appeared to us that the salespeople were told the minimum possible and then turned loose.

Finally, before we turn to the activities of the individual salespeople, we would like to make it clear that we do not accept the evidence which suggested that there was any real attempt at an effective "compliance" effort by Trend, Mr. Kruger or Mr. Swartz. Without putting too fine a point on it, we have concluded on the basis of all the evidence we heard that the total effort at Trend was to sell to anyone who could be persuaded to buy by whatever means were necessary."

At p. 1759, the Commission went on to say:

"The evidence of each of the witnesses called by the staff of the Commission, and indeed of those called by the Respondents, was clear that clients were not told at the time when purchasing shares of Thunder Bumpers pursuant to recommendations of Trend salespeople that Trend was selling as principal. The fact that sales slips confirmed that this was the case does not in our view deal with the issue of whether or not there should have been disclosure at the time of sale. In the circumstances of this case, it is our view that the salespeople, in order to deal fairly with their clients, had a clear obligation to indicate that the securities sold were from the inventory of Trend. As well we believe that salespeople had an obligation to indicate the price at which the shares were acquired by Trend and therefore the mark up that was being charged. It is not any answer from either the salespeople or Trend to say that the salespeople were not told the acquisition price. They should have been told - and when they were not, they had a responsibility to ask. Whether or not the mark-up was excessive or unconscionable, it is very clear that these shares were not being sold at a price established in the public market place. They were being sold as part of an arrangement whereby Trend was purchasing as many shares it could acquire at a net cost of 31¢ (and greater as time went on) and was selling them at mark-ups in the neighbourhood of 100% although they varied on either side of this from time to time. Mr. Kruger told us that the price was determined solely by a calculation of the acquisition cost, the commission paid to salespeople, the cost structure of Trend and an additional amount for Trend's profit. There was absolutely no effort to determine the market or underlying value of the shares."

At p. 1762, the Commission said:

"There was in our view an obligation to disclose the fact that this was a trade made as a principal transaction and the extent of the mark-up being charged. The failure to do so was in our view a

part of what constituted an arrangement or process which misled clients as to the true nature of this transaction and the true business background and viability of the Thunder Bumpers."

"Section 102(4)(b) [now section 114(4)(b)] of the Regulations to the Act provides in part as follows: "each dealer...shall make such inquiries as... are appropriate in view of the nature of the client's investment and of the type of transaction being effected for its account, as to the general investment needs and objectives of each client and the suitability of a proposed purchase or sale for that client."

This regulation, which is known as the "suitability and know your client" requirement, is fundamental to the obligation of every dealer dealing with the public. As our analysis of the evidence will disclose, we have concluded that little if any attention was paid to this obligation by Trend or by Messrs. Kruger and Swartz."

The Commission stated at p. 1763:

"The core of the allegations in the Notice of Hearing is that the Respondents and each of them failed to deal fairly, honestly and in good faith with Trend's clients. This is the fundamental requirement of every Registrant, and is set out clearly and unequivocally in Regulations 196 and 197. There was an abundance of evidence by witnesses, not only those called by staff but of those Respondents who testified which established this to our entire satisfaction. This matter is similar in many respects to that which the Commission considered in the case of In the Matter of Rosmar Corporations Limited et al (1982) 3 O.S.C.B. 11C. As the Commission pointed out at p. 35c and following "a special obligation devolves upon those who are registered in this province to sell securities. Securities may not be sold as any other commodity to any willing buyer. The potential for harm to the unwilling, the unsophisticated and the naive, even though they may well be greedy and hope for the return of a quick dollar, calls for the surveillance of securities sales techniques."

In In the Matter of Goldmack Securities Corporation (1966) O.S.C.B. 18 the Commission commented that a Respondent was "of the view that his actions met the acceptable standards of the business", and went on to say, "As a registrant he should have appreciated that his responsibility to the public is at a much higher level than his conduct indicates. A registrant engaged in the distribution of securities has a responsibility not only to his particular client, but

to the public at large." These words apply equally to each of the Respondents in this case, each of whom in our view displayed a total disregard for the interests of anyone other than themselves. The Commission has made it clear on many occasions that by seeking and holding registration, registrants represent that they will deal fairly with the public as indeed they are required to do under the Regulations. We are satisfied that not one of the Respondents in this case met this basic requirement.

The regime of securities regulation established by the Act and the Regulations, and discussed in decisions of the Commission and the Courts makes it clear that obtaining registration entitling persons to deal with the public is a privilege and not a right and that this must constantly be borne in mind. As part of this, every salesperson must among other things, be familiar with and follow the precepts of the Manual for Registered Representatives. Having sat through this hearing, it is clear from even a cursory review of the Manual that the Respondents in this case and each of them was either unaware of or paid scant attention to the Manual. The very first item in the Code of Ethics and Conduct for Registered Representatives provides that the client's interest must be the foremost consideration in all business dealings. It was not in this case. The code provides that all methods of soliciting and conducting business must be such as to merit public respect and confidence. They were not in this case.

In short, there was a total disregard by all of the Respondents of even the most basic obligations and responsibilities which go with registration and the resulting privilege of dealing with and selling securities to the public.

We are satisfied that most if not all of the Trend customers who gave evidence were innocent victims who relied upon Trend and its salespeople deal fairly and equitable with them. In any event, the Commission has long held that, as the then Director of the Commission said in the Adelaide Securities Limited case, 1968 OSCB 57 "Whether one believes one or more of these purchasers to be stupid or naive, gullible or greedy, this does not make them fair game for the party who seeks them out."

At p. 1769, the Commission said:

"In short, we are satisfied that each of the Respondents acted in total disregard of anything other than their desire to sell shares of Thunder Bumpers acquired by Trend at a profit to Trend and themselves. The result of their conduct insofar as the clients who acquired shares of

Thunder Bumpers is concerned is obvious. Each and every person who gave evidence lost all or a substantial part of their "investment". While that loss to clients is not in itself enough to warrant sanctions against those who sell securities to the public, nevertheless when the loss results from conduct such as we have considered at this hearing, and summarized in this decision, the concerns transcend the problems created for those individuals who suffered the loss. In our view what the Respondents did was clearly detrimental to the public interest, would, if not sanctioned, be likely to be repeated and is precisely the kind of activity calculated to raise serious questions with respect to the integrity of the capital markets."

### **Specific Abusive Sales Practices**

In addition to the operation of a Boiler Room, Manning, and certain of the other Respondents, were engaged in a number of abusive sales practices which would justify, in the circumstances of this case, the imposition of sanctions pursuant to the Commission's clause 127(1) 1. and 3. powers.

#### *Misrepresentations About Issuers*

As part of their selling techniques, Elik, Ted Manning, Finance, and Bolton routinely made misrepresentations about the issuers of the shares which they were attempting to sell and the businesses and business activities of those issuers. It appeared to us from the evidence that these Respondents were prepared to say whatever it took to convince a customer to purchase, or not to resell, Manning product, without any concern as to whether what was being said was true or not.

#### *Failure to Adequately Disclose Commissions*

Openers and Loaders (the latter subject to splitting the commission with the applicable Opener) were paid by Manning a substantial commission, normally 17 1/2 percent of the gross selling price to the customer, on sales by them of Manning product. According to the former Manning customers, none of them was ever told the amount of the commission by an Opener or Loader who sold them shares.

Manning confirmation slips have in recent times, but not theretofore, set out the approximate rate of the commission paid to salesmen in a code which was explained on the reverse of the slip. None of the former Manning customers was ever advised to look at the reverse of the slips, nor was any given an explanation of the code.

The front of the Manning confirmation slips disclosed a "commission or transaction fee" which was normally the greater of \$20 and 2 percent of the amount paid by the customer. The evidence of those former Manning customers who gave evidence on this point was that they assumed that the salesman's commission came out of this "commission or transaction fee", and the evidence of the Inside Witnesses was that this was the impression intended to be conveyed.

The former Manning customers were not told that the salesman's commission would have to be repaid if the shares were resold within 90 days or that the salesmen would not receive any commission on resales or on sales of securities other than Manning products.

If the former Manning customers had been told of the rate and terms of payment of salesmen's commissions, which differed materially from the norms in the investment business, they would have been much less likely to accept the assurances of Manning salesman that the salesman's primary interest was that the customer make money, that the customer would be told when to resell their shares and that "when you make money, I make money".

#### *Failure to Adequately Disclose Principal Selling*

As above stated, Openers were trained to insert in their sales pitches a statement that Manning was selling as principal, but without any explanation of what this meant. Confirmation slips stated that the sale was as principal and, in recent times, but not theretofore, the slips also contained a code reference on the front, explained on the back, to Manning's average cost of the shares being sold. Letters sometimes, but it would appear not always, forwarded to customers, usually after the sale was made, also stated that Manning was selling as principal.

However, there was no oral or written explanation to the former Manning customers as to what selling as principal meant, and the evidence of each was that he or she did not understand that it meant that Manning was selling the shares out of its inventory. Instead, they thought that the sale proceeds were going to the issuer. Nor, apart from the coded reference referred to above, was there an explanation to the former Manning customers that the shares had been obtained by Manning at a substantially lower price than that at which it was being sold to the customer. Nor was there any disclosure to the former Manning customers that Manning controlled the market for and the price of the shares, and that any resale of the shares would, on a practical basis, have to be to Manning if it could be made at all.

Had the former Manning customers known these facts, they would have been far less likely to believe that the Manning salesmen were acting in the customer's interest and not their own or that of Manning, or the many reasons that they were given as to why their shares could not be resold.

#### *Failure to Adequately Disclose Risks*

As previously stated, the shares sold by Manning were, to describe them as favourably as possible in view of the manner in which they were marketed, highly speculative. As also previously stated, Manning salesmen were trained to mention that the shares which they sold involved some risk, but to play down the risk and emphasize the almost certainty of profit. They did so, and certainly did not mention the fact that there was every reason to believe that the customer would lose a substantial portion of his or her investment. Not surprisingly, few of the former Manning customers who

testified on the point remembered any mention by the Manning salesmen of risk.

With the possible exception of Webb and Dritsas, none of the former Manning customers seem to have received the risk disclosure letter from Manning a copy of which was included in a group of documents filed by us with Mr. Lenczner as being documents all of which were sent by Manning to its customers. Nor do they seem to have received letters with respect to individual offerings containing the risk disclosure language contained in the form of letter included in that group of documents or, indeed, some of the other such documents. Accordingly, we are unable to place much credence in the assertion that this material was all sent to Manning customers.

Had the real risks involved in purchasing shares from Manning been disclosed to its customers, it is difficult to believe that any of them would have purchased any shares from Manning.

#### *Representations as to Future Prices*

Elik and Ted Manning gave explicit or implicit assurances to former Manning customers relating to the future prices of shares sold by Manning, both in the course of attempting to sell the shares to the customers and in the course of attempting to convince the customers that they should hold on to the shares. These assurances contravened the spirit of, and perhaps as well the prohibition contained in, subsection 38(2) of the Act.

#### *Representations as to Inside Information*

Elik, Ted Manning and other Manning salesmen intimated to customers that their recommendations were based upon knowledge of favourable inside information. Manning salesmen were trained to do so. If they did have such information, it was improper of them to use it for such a purpose. If they did not (and it would appear that they did not), then their misleading of customers was equally improper.

#### *"Wooden Orders"*

Elik and other Manning salesmen engaged in unauthorized trading in customers' accounts. The practice is known as the use of "wooden orders". They would send a confirmation to a customer with respect to shares that the customer had not agreed to purchase, in the hope that the customer would later agree to take some or all of the stock, the price of which would in the meantime usually have been raised.

#### **Failure to Comply With "Know Your Client" and "Suitability" Requirements**

We have already discussed Manning's blatant disregard of and failure to comply with the "know your client" and "suitability" requirements of section 114 of the Regulation in connection with our discussion of Manning's Boiler Room operation. These requirements are an essential component of the consumer protection scheme of the Act and a basic

obligation of a registrant, and a course of conduct by a registrant involving the failure to comply with them is an extremely serious matter. A selling scheme which depends for its success on flouting the rules is an even more serious matter, and one which would, apart completely from the Boiler Room activities involved in the scheme, justify us in imposing sanctions under clauses 127(1) 1. and 3.

#### **Other Improper Activities**

##### *Failure to Issue Monthly Statements of Account*

Manning did not send statements of account to its customers as required by section 123 of the Regulation.

##### *Failure to Permit Customers to Sell Shares*

The former Manning customers were assured by the Manning salesmen who dealt with them that the customer would be told by the salesman when to sell the shares. The evidence was that, except in connection with switches, they were never told to sell the shares, either when the share price had increased or when it had started to drop. Indeed the "cooling" process, and the putting in of sale orders at or above the ask price, described above, were used by Elik, Ted Manning, Bolton and other Manning personnel to ensure that resales by customers only took place in unusual circumstances. Manning had no interest in increasing its inventory to benefit its customers.

##### *Attempts to Deceive the Commission*

Darling testified that Judith Manning told him:

"If you get to the Commission, deny it all. Deny anything spoken";

and that Fritz had told him that "under examination, under the up and coming hearing I can say that the Commission put words in my mouth and the Commission put pressure on me to fabricate information in order to be able to get my license transferred, in order for an expeditious transfer of my license". He also testified that what Fritz told him to say was untrue.

#### **Breach of Fiduciary Duty**

The Manning salesmen (and most particularly the Loaders) with whom the former Manning customers dealt continually assured the former Manning customers that they could rely on the Manning salesman to tell the customer what and when to buy and sell, and insisted that the customer should not make any sale until told to do so by the Manning salesman. The Manning salesmen held themselves out as skilled, knowledgeable and experienced investment professionals, working for a dealer which had been in business for many years, who could be relied on to advise the customer well and take care of the customer's interests, and on whom the customer could completely depend for disinterested investment advice. The Manning salesmen sought and obtained the trust of the customers.

As a result, Manning and the Manning salesmen were in a fiduciary relationship with the customers, and, as a result, had, in equity, a strict obligation to deal fairly, honestly and in good faith with the customer and to fully disclose to him or her, in a timely manner, all information in the possession of the fiduciary relevant to the transactions in which they were involved. This obligation existed as a matter of general law.

In *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 at 419, La Forest, J. described the position as follows.

"Much of this caselaw was recently canvassed by Keenan J. in *Varcoe v. Sterling* (1992), 7 O.R. (3d) 204 (Gen. Div.), in an effort to demarcate the boundaries of the fiduciary principle in the broker-client relationship. Keenan J. stated, at pp. 234-36:

The relationship of broker and client is not *per se* a fiduciary relationship... Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not exist... The circumstances can cover the whole spectrum from total reliance to total independence. An example of total reliance is found in the case of *Ryder v. Osler, Wills, Bickie Ltd.* (1985), 49 O.R. (2d) 609, 16 D.L.R. (4th) 80 (H.C.J.). A \$400,000 trust for the benefit of an elderly widow was deposited with the broker. An investment plan was prepared and approved and authority given to operate a discretionary account... At the other end of the spectrum is the unreported case of *Merit Investment Corp. v. Mogil*, Ont. H.C.J., Anderson J., March 23, 1989 (summarized at 14 A.C.W.S. (3d) 378), in which the client used the brokerage firm for processing orders. He referred to the account executive as an "order-taker", whose advice was not sought and whose warnings were ignored.

The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the client's trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith... It is the trust and reliance placed by the client which gives to the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and have given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.

In my view, this passage represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers, or investment counsellors. Moreover, it states a principled and workable doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor."

Similarly, in *Burke v. Cory* (1959), 19 D.L.R. (2d) 252 at 258, Schroeder, J.A. had the following to say.

"The learned trial Judge acknowledged the validity of the proposition advanced in support of the first ground of appeal, but he held that a fiduciary relationship had arisen between the parties. He emphasized the fact that the defendant's salesmen had informed the plaintiff of the special advantages enjoyed by the defendant which enabled him to make a most skilful analysis and provide the most reliable information with respect to the stocks in question. He also observed that while the plaintiff was made aware that the defendant was acting for the vendor and received the defendant's bulletins without charge, they were furnished gratuitously "for the obvious purpose of inducing the plaintiff to sample the defendant's wares". Finally, the learned trial Judge states:

"Because of the nature of the defendant's business and because he endeavoured to induce the plaintiff to believe that he had exceptional skill and ability to furnish valuable advice in respect of shares to be bought and sold, a different and special relationship was, to my mind, developed: one, which required the defendant to advise fully, honestly and in good faith when undertaking to either give advice or proffer recommendations."

and he held that the defendant had been brought within the rule enunciated by Davis J. in *Glennie v. McDougall & Cowans Holdings Ltd.*, [1935], 2 D.L.R. 561 at p. 579, S.C.R. 257 at p. 277.

I agree with the conclusion reached by the learned trial Judge that the relation existing between these parties imposed a duty on the defendant to advise the plaintiff carefully, fully, honestly, and in good faith. Courts of Equity have long exercised a special jurisdiction over the dealings of persons standing in certain fiduciary relations, and the principles which govern transactions between persons standing in such a relation as, e.g., solicitor and client,



guardian and ward, medical adviser and patient, spiritual or religious adviser and parishioner, parent and child, have been held to apply generally also to the case of persons who clothe themselves with a character which brings them within the range of those principles. This proposition was stated most admirably by Lord Chelmsford L.C. in the oft-cited case of *Tate v. Williamson* (1866), L.R. 2 Ch. 55 at pp. 60-1, from which I quote: "The jurisdiction exercised by Courts of equity over the dealings of persons standing in certain fiduciary relations has always been regarded as one of a most salutary description. The principles applicable to the more familiar relations of this character have been long settled by many well-known decisions, but the Courts have always been careful not to fetter this useful jurisdiction by defining the exact limits of its exercise. Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed."

The Courts have not endeavoured to define with any attempt at precision what constitutes such a relation. The cases to which the principle has been applied are only instances, and whether the relation exists or not is a question of fact which must be determined on the facts and circumstances of each individual case.

The dealings between a broker and his customer may well be of such a character as to bring into being a fiduciary relation between them. An instance of this is to be found in the judgment of the Supreme Court of Canada in *Glennie v. McDougall & Cowans Holdings Ltd.* where, at p. 579 D.L.R., p. 277 S.C.R., Davis J. stated: "During the argument the nature and extent of the rights and obligations of brokers to their customers were broadly discussed by counsel but is unnecessary for us in this case to attempt to lay down any general statement. The customer here requested the brokers to sell. The brokers undertook to advise the customer at that time not to sell, for that must be involved in the findings of the jury. *Having so undertaken to advise, the brokers undoubtedly owed a duty to their customer to advise fully, honestly and in good faith*, and the non-disclosure to the customer of their own substantial interest in the stocks that he was carrying and wanted to sell was a breach of duty for which the brokers were

liable for any damages suffered by the customer in consequence of that breach of duty." The principles there enunciated is applicable to the facts of this case. While it is true that the defendant assumed the role of agent for the vendor of the stocks in question, nevertheless he went to great pains to convince the defendant of his pre-eminent qualifications as an "investment counsellor", and of his possession of vital private information in relation to the stocks which he was advising him to buy. In fact he went to the greatest lengths to gain the plaintiff's confidence and when he succeeded he abused it in a manner which reflects discredit both upon himself and his agents."

In *Scherer v. Zacks* [1952] 4 D.L.R. 503 at 506, McRuer, C.J.H.C. said the following.

"In *Johnson v. Birkett* (1910), 21 O.L.R. 319, Riddell J. pointed out the duties of a stockbroker toward his client. They may be simply stated: (a) He is the same as any other agent acting for a principal. (b) He has a duty to act in the interest of the principal. (c) He is not permitted to allow his personal interests to conflict with the interest of the principal unless he has made full and fair disclosure of all material facts relative to the transaction and his interest in the transaction.

An agent may sell his own property to the principal if it is proved that no advantage was taken by the agent of his position and the transaction was entered into in perfectly good faith and after full disclosure, but the onus of proving this lies on the agent.

In this case the broker was not only selling his own stock to his principal but was selling it at a fictitious market price created by a highly secret scheme in which the agent was actively participating.

The evidence given for the plaintiff conclusively shows his right to recover the amount claimed..."

In our view, Manning, and its salesmen, including Elik, Ted Manning and Finance, as well as Bolton, were in a fiduciary relationship to the Manning customers with whom they dealt. They clearly failed to disclose to the former Manning customers in a timely, clear and unambiguous manner, many things which they should have disclosed, including the facts that Manning was not a dealer in securities in any real sense of the word, that the shares which they sold were being sold out of Manning's inventory at a considerable profit, that Manning was the real market for those shares, and, on a practical basis, the only purchaser for their resale, that Manning had no intention of repurchasing the shares, the real risks involved in the purchase of the shares, and the fact that the Manning salesmen had no intention whatsoever of

advising their customers honestly and in the customer's interest.

Obviously, if they had made such disclosures in a forthright manner, they would not have had any customers. This made the disclosures even more necessary in a fiduciary context. Instead what disclosure there was, was made in a manner which in our view was designed to obscure, and had the effect of obscuring rather than revealing, so as to produce a favourable paper trail, without bringing home to the customer those things which he or she ought to have had made clear by someone in a fiduciary relationship.

In our view, their gross failure to satisfy fiduciary obligations evidenced by the facts of this case provides another basis upon which we can properly sanction these Respondents under clauses 127(1) 1. and 3..

#### **Failure to Establish and Supervise Adequate Compliance Procedures**

It is clear from the evidence that Manning failed to establish and enforce procedures for dealing with clients that conformed with prudent business practice, as required by subsection 114(1) of the Regulation. Adequate procedures would have prevented the operation of a Boiler Room as well as the operation of Manning's selling scheme. Darling testified as follows:

"Look. I mean there was no compliance. We had a compliance meeting if that is what you mean. We had a compliance meeting in the beginning, but again it was basically empty. It was just to show what to say on the New Client Application Form to protect management and the company's and the sales people's interest.

Now, as far as enforcement was concerned, I did not personally see any enforcement, okay. Every trade that I made went through, I did not have one that was rejected, okay, every account we opened up went through. Sometimes they would make a scene or something like, "Oh, you should say this.", but it was all stage act. I mean every account was opened up. Like we were trained to, like during meetings with Ted Manning we were trained to, you know, use a high figure when we were putting in like net worth or income to, you know, give it a positive light so it would be helpful. So, we were partly trained, there was a linkage between that and, you know, using high numbers, you know, on the New Client Application Form and using leading questions. And as far as compliance was concerned there was no enforcement."

The evidence of the other Inside Witnesses was supportive of this statement.

In his "opening", Mr. Lenczner referred to a "policies and procedures manual" which Manning had quite recently put

in place and asked us to look at this because "I think you will see that the policies and procedures manual of this firm are [sic] exceptional". He undertook to provide us with a copy, although he did not do so. However, one of the Inside Witnesses did produce a copy of such a manual.

From the evidence of the Inside Witnesses, we have concluded that this manual was put in place as part of the "paper trail" attempted to be created when the "know your client" and confirmation forms were changed and "risk disclosure" letter created, but that it was never enforced by Manning.

*In Varcoe v. Sterling et al* (1992), 7 O.R. (3rd) 204 at 239, Keenan, J. said the following:

"If statutory regulation imposed for the protection of the public is to have any meaning, it must be enforced and obeyed. It is not enough for a broker to file a compliance manual full of rhetoric and straw rules. A manual called "Doing What's Right" is more than a cute play on the initials of Dean Witter Reynolds. There is a statutory requirement and a duty to the customer to comply and to enforce it.

If the industry and the regulatory authorities permit member brokers to ignore or violate their own rules and blame losses on the cupidity of the customer, then it falls to the court to provide a remedy."

Although this holding related to obligations under the *Commodity Futures Act*, it is equally applicable to obligations under the *Act*, and we, with respect, agree with it fully.

Judith Manning, as president of Manning, cannot avoid responsibility for this failure, whether or not she was a participant in the other improper activities which we have dealt with above. (In fact, we find it impossible to believe that she could not have been aware of these activities, even if she was not a participant in them, which, on the basis of the evidence which we heard, we think she was.)

The senior officers and compliance officer of a registrant cannot, and should not be able to, play ostrich when the registrant's salesmen or other officers or employees contravene Ontario securities law or otherwise behave improperly in relation to the registrant's clients. They are responsible to put in place and police procedures adequately designed to prevent this from happening. This also applies to the registrant itself.

In *In the Matter of Gordon-Daly Grenadier Limited et al* (1978), O.S.C.B. Vol. 13 p. 238 at 245, the Commission said the following.

"At least one other aspect of the facts established before us supports the penalties that we assessed. It was obvious to us from the testimony that Mr. Mourin did not maintain adequate control over the activities of

his salesmen. Apparently a cursory examination of the daily blotter represented the extent to which he carried out his supervisory responsibilities. That is unacceptable. Particularly when they are engaged in the sale of speculative securities, salesmen should be supervised on a continuing basis by a responsible individual to ensure that they are in compliance with the Act, and the regulations and policy statements adopted thereunder."

Similarly, in *In the Matter of Christopher James Chappell et al* (1987), 10 O.S.C.B. 4000 at 4008, the Commission had this to say.

"A burden of adequate supervision to ensure proper conduct and fair dealings with retail clients falls on all registrants. Compliance with the rules of conduct set out in the by-laws and the regulations of the self-regulatory organizations and the rules under the Securities Act must be given the highest priority by senior officials of registrants. Midland did not discharge such obligations in respect of its employment of Chappell.

The Commission takes the view that when a registered representative contravenes the Securities Act, the firm employing the registered representative has at least some degree of complicity. In the case of Chappell, Midland's knowledge of Chappell's conduct and the paying of compensation to clients clearly increases its complicity. The failure by Midland to properly supervise Chappell was compounded by failing to advise the Commission as to the full reasons for his termination as its employee.

The Commission has in the past tended to take enforcement procedures against the particular individuals who have breached the Securities Act or the rules of the TSE or the IDA. The Commission is, however, of the view that a greater focus on the conduct of the dealers employing such registrants is appropriate. It is true that adverse publicity attending enforcement procedures is a considerable penalty in itself. However, the Commission wishes to put the industry on notice that in the future it proposes to consider more stringent penalties for compliance officers, senior officers and registered dealers in connection with the conduct of their employees."

Fritz was Manning's compliance officer as well as one of its directors and vice-presidents. In addition to her obligations as a senior officer of Manning, she had the primary responsibility as compliance officer to put in place and police the sorts of procedures we have discussed above. She did not do so.

There was filed with us a copy of a letter from Fritz to one Rami Sadawi, on Manning letterhead, dated September

19, 1994, a copy of which was sent to the Staff. In this letter, Fritz said the following:

"I am the Compliance Officer for this company. One of my functions is to monitor the telephone conversations of my Representatives to ensure that they are adhering to the rules and regulations as set out in the Ontario Securities Act."

If she in fact did this, Fritz could not have failed to know the improper activities going on at Manning. If she did not monitor the calls and, as we consider to be most unlikely, did not otherwise know what was going on, then she should have had in place procedures which enabled her to know what was going on.

#### **Allegations by Manning Against the Staff**

In the course of his "Opening", Mr Lenczner made some very serious allegations about the Staff and its handling of this matter. He alleged a deliberate move by the Staff in the early 1990s to put all the broker dealers out of business, culminating in Policy 1.10. He went on to allege that after the Policy was struck down, the Staff decided to do indirectly what it could not do directly, hence these proceedings. He went on a good deal about this sort of thing.

In fairness to the Staff, we must say that nothing which we heard or saw in this hearing lent any credence whatsoever to these allegations. We have no doubt that the Staff thinks that Manning should be put out of business. That is what the Staff is asking for in these proceedings. It is the business of the Enforcement Branch of the Staff to investigate alleged and suspected breaches of Ontario securities law and other improprieties, and, if they think that the evidence warrants it, to commence proceedings which can and do include proceedings for the cancellation of a registrant's registration. It can hardly be argued that this is improper. The entire securities regime in this Province depends in no small part on proper enforcement of the rules of the game.

The evidence which we heard fully supported the bringing by the Staff of these proceedings.

#### **The Nature of These Proceedings**

The regulatory nature of proceedings of this type was described by the Divisional Court in *Gordon Capital Corporation v. Ontario Securities Commission* (1991) 14 O.S.C.B. 2713 at 2723 as follows.

"The general legislative purpose of the Act and the OSC's role thereunder is to preserve the integrity of the capital markets of Ontario and protect the investing public. In this context, the proceedings against Gordon and Bond under subsection 26(1) of the Act are properly characterized as regulatory, protective or corrective. The primary purpose of the proceedings is to maintain standards of

behaviour and regulate the conduct of those who are licensed to carry on business in the securities industry. The proceedings are not criminal or quasi-criminal in their design or punitive in their object. This distinction has been made in a number of cases involving proceedings of a regulatory or public protective nature such as that under Subsection 26(1) of the Act."

The Commission, in *In the Matter of Trend Capital Services Inc. et al* (1992), 15 O.S.C.B. 1711 at 1748, outlined the basis on which the Commission should proceed.

"Staff, in the Notice of Hearing which initiated these proceedings, have asked the Commission to sanction the Respondents for a variety of alleged activities all of which involved the sales of shares of Thunder Bumpers to members of the public.

In making an order under either of these statutory provisions [i.e. the provisions which corresponded to clauses 127(1) 1. and 3.], the Commission must come to the opinion that it is in the public interest to do so. The Courts and the Commission in prior hearings have established guidelines as to when and in what circumstances the discretion vested in the Commission by the Act should be exercised. It has long been recognized that the Commission's jurisdiction and consequently its responsibility under section 27(1) of the Act is very broad. In the case of *Re the Securities Commission and Mitchell* [1957] O.W.N. 595, Laidlaw, J.A. said

"The Commission has the right to suspend or cancel registration of any person, notwithstanding the fact that there has been no breach of any provision of The Securities Act or any regulation made thereunder: *Re The Securities Act and Gardiner, et al.*, [1948] O.R. 71 at p. 80, [1948] 1 D.L.R. 611."

and

"Finally, the Commission may properly form its opinion to suspend or cancel any registration in the public interest without proof of actual injury to the public."

The Commission itself has repeatedly held that the discretion vested in it should be exercised in favour of making an order where the evidence establishes that there has been a reasonable likelihood that such conduct may continue in the future unless the Commission moves to prevent a recurrence. Examples of this view of the

Commission may be found in the recent decisions of *Re Mithras Management Ltd.* (1988) 11 OSCB 1600 and *Re Gordon Capital Corporation and David Bond* (1990) 13 OSCB 2035. The latter decision of the Commission was upheld by the Divisional Court and reported in (1991), 14 OSCB 2714.

Arguments were addressed as to the standard of proof which we should apply, having regard to the fact that in this hearing we may well be considering sanctions affecting the ability of people to earn their livelihood. In our view the burden of proof rests with staff of the Commission to establish to the satisfaction of the panel that it is obliged, in order to protect the public interest, to sanction the Respondents. We in determining this have had to balance the interest of the Respondents in their right to earn a living in the investment industry and, in the case of Trend, to run a business and employ approximately 50 people, against our obligation to protect the public interest.

Both sections of the Act under consideration require us to form an opinion that a decision to sanction is in the public interest. In our opinion there are two issues which require consideration. The first, already mentioned, is whether or not, assuming the conduct is objectionable, there is a reasonable likelihood it will be repeated. The second is whether or not the conduct of the Respondents, if objectionable, is such as to bring into question the integrity and reputation of the capital markets in general. These were the tests which we followed in reaching our conclusions.

The burden of proof which staff must satisfy before we decide to act under these sections is not in our view as strong as that which would be required if these were criminal proceedings. In any event, in this case there was really no doubt left in our minds as to the conduct complained of in fact having occurred, or the necessity of sanctions being imposed."

### Imposition of Sanctions

Like the panel in *Trend*, we have no doubt whatsoever that the conduct complained of in fact occurred. The question which must then be determined is whether sanctions are appropriate and, if so, what the sanctions should be.

In *In the Matter of Mithras Management Ltd. et al* (1988), 11 OSC 1600 at 1610, the Commission set out the relevant considerations as follows:

"Under sections 26, 123 and 124 [now section 127] of the Act, the role of this Commission is to protect the public interest by removing from the

capital markets -- wholly or partially, permanently or temporarily, as the circumstances may warrant -- those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under Section 118 of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all. And in so doing, we may well conclude that a person's past conduct has been so abusive of the capital markets as to warrant our apprehension and intervention, even if no particular breach of the Act has been made out. Equally, however, even if there has been a technical breach of the Act, we may well conclude that, in the circumstances, no sanction is necessary to protect the public interest. It may well be the rare case in which we reach such a conclusion, but in our view this case (or, at least, this branch of it) is one of them. Even if the Respondents' modified structure did violate clause 14(g), we are convinced that they would not have adopted it but for the reassurance they gained (and reasonably so, in our view) from what they said Mr. Steen told them. Accordingly, there is no basis upon which we can fairly say that the public interest requires us to intervene here."

Similarly, in *In the Matter of Gregory McGroarty et al* (1990), 13 OSCB 3887 at 3934, the Commission stated:

"we would say first that this present proceeding is not, as respondent's counsel seemed to characterize it, the trial of a provincial or criminal offence in which the prosecutor must make out every element of the offence charged before a conviction can be registered. Ours is an administrative proceeding, the focus of which is the protection of the public and not the punishment of an individual."

We agree with these statements. Like in the panel in *Mithras*, we are not prescient. The only way in which we can realistically look at the question of what may happen in the future in a case of this sort is to consider what the actions of the Respondents have been in the past. On the evidence, we are satisfied that it is necessary to impose sanctions under clauses 127(1) 1. and 3.. To permit the conduct of the Respondents to continue would be to seriously detract from the credibility of the capital markets in Ontario, as well as to permit investors to continue to be victimized.

There has been a lengthy and continuous course of conduct by Manning which exhibited a complete and callous disregard for Ontario securities law, the obligations of a registrant, the interests of the investing public and in particular the customers who Manning was supposed to be serving, the capital markets of this Province, and even common decency. The Commission has been advised that Manning filed an assignment in bankruptcy on October 6, 1995. However, the deficiency shown by its Statement of Affairs is a relatively small one, and a company which goes into bankruptcy can come out of it.

Manning's actions were directed by its officers, Judith Manning, Elik and Fritz, as well as by Ted Manning, each of whom, in addition, was guilty of other and serious personal behaviour which would, itself, justify the imposition of the most serious sanctions by us to protect the investing public and the capital markets of this Province.

Bolton aided and assisted in the carrying on of these operation, as did Finance, to a lesser but still serious extent, and each was, in addition, guilty of other and serious personal behaviour which would, itself, justify the imposition of sanctions by us to protect the investing public and the capital markets of this Province.

Unless the Respondents are removed from the capital markets, then based on their past performance there is, in our view, every reason to believe that they will continue to act in the same manner, in the case of the individual Respondents, however, probably carrying on their activities through another dealer.

The Staff has made out its case that it is in the public interest for us to make the following orders.

Accordingly, we order that:

- a. the registration granted to each of Manning, Judith Manning, Elik, Ted Manning and Fritz under Ontario securities law be terminated;
- b. the registration granted to Bolton under Ontario securities law be suspended for the period of ten years;
- c. the registration granted to Finance under Ontario securities law be suspended for the period of five years; and
- d. the exemptions contained in Ontario securities law do not apply to the Respondents named in a. permanently, to Bolton for the period of ten years and to Finance for the period of five years;

and in this order, "Ontario securities law " has the meaning ascribed to that term in the Act.

DATED at Toronto this 6th day of November, 1995.

"J. A. Geller"

"H. M. Meyer"